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DEVELOPMENT PLATFORM

ALTERNATIVE TAX EFFICIENT **INVESTMENTS**

An Adviser Guide

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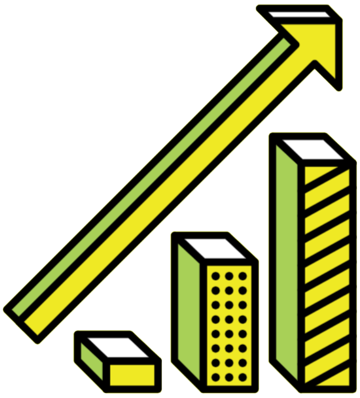

Haatch brings the benefits of tax-free growth, up-front income tax relief, CGT reduction and deferral, and IHT exemption to investors through its SEIS & EIS funds. Our 900 existing investors have a guaranteed route to support the UK economy through our 100 investee companies.

Haatch is a strategic Pre-Seed and Seed Fund that invests in business-to-business software companies solving deep pains in the present and/or creating massive impact for organisations. Our team uses its experience of taking companies from 0-to-1 and its entrepreneurial nous to identify, nurture and accelerate early-stage companies to their first £1m ARR and build the infrastructure to get to £10m+. We're experts in Founder-led-sales and building early sales teams.

At Haatch we leverage our information rights in companies to track the milestones and commercial goals that pinpoint progress. This way, the Haatch EIS Fund benefits from the ability to back the best performers of the Haatch SEIS Fund that are now on the path to proving they can scale. We also invest in new companies with the likes of British Business Investments (a wholly owned subsidiary of British Business Bank) which has invested £10m alongside Haatch in our Haatch SEIS & EIS funds as part of its pledge to fund early-stage businesses across the UK as part of its Regional Angels Programme.

We're passionate about democratising access to SEIS and EIS and became the first Fund to lower the barrier by launching our SEIS offering to retail investors with Crowdcube in 2023. But we never forget value and transparency, applying a single, upfront 10% fee, a substantial saving on the market average of 24% over a seven-year period, (MICAP, May 2024).

Contact details

Fred Soneya
Co-Founder, Partner

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→ Find out more

At o2h Ventures, we strongly believe in the UK's amazing science base and its incredible industrial, and academic talent. Additionally, the UK punches well above its weight, bringing in over 40% of all biotech investments across Europe as geography. Despite these facts, there is a significant and well-understood valuation gap between the UK and the USA. This is largely due to the quanta of seed capital available.

As a specialist biotech fund manager based in the heart of Cambridge's biotech community, we are an FCA-authorised venture capital company focused on investing in pure-play therapeutics, biotech enablers and the intersection between biotechnology and AI/ML. Leveraging our extensive grassroots experience in biotech, we have built a 'flywheel' to support and nurture early-stage biotech companies.

To date, we have invested over $10M in more than 33 biotech companies, many of which have shown significant progress since our early-stage investment. Our investments focus on diseases with high unmet medical needs, including cancer, depression, disease of the ear and eye, psoriasis, idiopathic pulmonary fibrosis, anti-ageing, and infectious diseases. Additionally, our portfolio has attracted over $400M of capital in subsequent capital rounds.

Our strategy aims to build a pipeline of innovative medicines and investment opportunities for later-stage funds and pharmaceutical companies to invest in or acquire. We focus on de-risking the investments by understanding areas of high interest to big pharma and then providing 'hands-on' support via team building, mentoring, fundraising, scientific support, and seeking commercial partnerships.

Contact us to learn more about the specialised human health funds

Contact details

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Visit website

SFC Capital

Recent changes have transformed SEIS into an invaluable investment tool for financial advisers. Since then, IFAs have been entering the market in record numbers, taking advantage of uniquely generous 50% income and capital gains tax relief, 100% inheritance tax relief, tax free growth, and an increased investment limit of £200,000 per year. Are you?

SFC Capital is the UK's leading SEIS Fund Manager, managing over £100 million and supporting 450+ portfolio startups. As 3x consecutive winners of Best SEIS Fund Manager at the EIS Association Awards, our deep understanding of SEIS investing and commitment to excellence has pioneered the benchmark others seek to emulate today.

Our rapidly expanding network of financial advisers benefit from our expertise in managing diverse portfolios of high-potential startups across sectors like ClimateTech, BioTech, HealthTech, B2B Software, and more. Partnerships with organisations like the British Business Bank and Innovate UK, plus leading universities, accelerators, and super angels, place SFC at the forefront of early-stage innovation in this country and helped make us the UK's most active venture capital firm.

SFC's unique investor management system is tailored to meet the needs of busy financial advisers, with our bespoke investor portal providing a full-spectrum investor and adviser experience, ensuring a seamless and efficient ongoing management process.

Our highly experienced team has a proven track record of delivering results. We are ready to guide you through the terrain of tax-efficient SEIS investing.

Contact us to learn more about SEIS and how to incorporate it into your client offerings.

Contact details

invest@sfccapital.com

Visit website

CPD

The Adviser Guide to **Alternative Tax Efficient Investments**

ZISHI

ZISHI have accessed this material for CPD Eligibility. As an accredited CPD provider, ZISHI have assessed this material as **45 minutes** of unstructured learning with the following learning outcomes.

Learning outcome

1. Understand how freezes to tax thresholds and allowances are driving more receipts for HMRC and more potential clients of tax-efficient investments
2. Define the key differences between SEIS, EIS and VCT investments and what they can do for clients
3. Appreciate the main considerations relating to exits fromv
4. Explain the practicalities associated with EIS follow-on investments
5. Identify key Consumer Duty requirements relevant to recommending high risk alternative investments
6. Access additional sources of educational, statistical and practical information that can be used with clients or for strategic planning and/or CPD purposes.

Contents

INTRODUCTION

Where do we stand with tax-efficient alternative investments?

Welcome to the Adviser Home guide to **alternative tax efficient investments**.

For the purposes of this guide we are focusing on the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trust (VCT). Their target investees are unlisted companies, meaning that they are not closely correlated to the economy or stock markets. They are also not viewed by many as traditional investment structures, hence they tend to carry the label of alternative investments.

For many advisers, though, this isn't an area they're particularly familiar with, much less one they aim to recommend to clients. But to avoid it altogether is becoming an increasingly risky strategy.

All three of The UK's venture capital schemes, the EIS, SEIS and VCTs offer substantial up front income tax relief and tax-free growth, while EIS and its smaller counterpart, SEIS also grant CGT deferral or relief and IHT exemption, and tax-free dividends are available through VCTs. Subject to similar rules in terms of the investee companies, these schemes were set up by government with the aim of encouraging investment into small, young companies that might otherwise struggle for funding. While SEIS is explicitly targeted at start-ups and very early-stage companies, EIS can be used by larger and more mature SMEs as is the case for VCTs.

With the eldest of the schemes, EIS, hitting its 25th anniversary this year, ongoing cross-party support bolsters demand for the solutions they offer. But the perception of them as niche investments hangs on. Advisers with experience in the sector, including **Stephen Jones**, financial planner and managing director of Clear Solutions Wealth and Tax Management though, views this as unfortunate. He says:

> *"I think attitudes are slow to catch up with the reality of the available opportunities. We (the advisers) need to recognise and most importantly communicate the value this sector brings: real added value, investment diversification, and dare I suggest, excitement."*

It's true that times haven't been easy over the last two or three years. In 2022/23, EIS funding dropped by 15% on 2021/22 levels. However, investment in 2022/23 saw a reduction down to average levels seen prior to the previous year's increase, which was itself a rebound from the pandemic. SEIS and VCTs saw the same corrective trajectory with 24% and 6% decreases respectively.

> According to, *"the data for the 2022/23 tax year, whilst lower than the 2021/22 record breaking numbers, shows a return to pre-pandemic levels. Whilst it has definitely been a more challenging year for fundraising and the wider economy, there is also significant evidence to suggest that economically challenging times provide tremendous opportunities for startups. A recent report from Beauhurst found that UK businesses founded between March 2020 and January 2022 have participated in 6.15k fundraising deals, raising £14 billion in equity investment and have collectively generated a turnover of £440billion."*

Continue

“ **Nick Britton**, Research Director of the Association of Investment Companies, agrees fundraising drops, *“reflected a tougher economic environment, with sharply rising interest rates and higher inflation.”* Moving forward, with half of the world’s population voting in national elections in 2024, that’s more voters than ever in history, it’s hard to argue that additional uncertainty won’t be in the air.

Yet, IFAs with a focus on alternative tax-efficient investments have expressed that the venture capital scheme tax reliefs continue to do exactly what they are designed to do; encouraging clients who want to invest into small UK companies to support the UK economy with risk mitigation from the tax reliefs.

“ **Jones** thinks *“it was always going to be a challenge to maintain the last few years level when clients were reining in their exposure to the venture capital space. But, as almost all the market has experienced down rounds this has created a wonderful opportunity to carefully pick some great growth opportunities. I hope this slight drop in client confidence will help advisers and their clients realise it is the underlying investment not the tax structure which is the most important decision.”*

He goes on, *“Anecdotally, I hear considerable amounts of foreign investors are attracted to the underlying investee companies. Given they do not receive the tax reliefs, one reasonable inference is that they see them as cheap assets and just as we saw in the main markets a few years ago, a great way to access the IP.”*

“ **Britton** believes that, *“VCTs are now primed for recovery… We’re just seeing the first interest rate cuts in the eurozone and in Canada, and once rates start heading south, that’s positive for growth companies. Fundraising for the last tax year was down, but still the third highest on record, giving VCTs plenty of dry powder to go out and look for deals at valuations that are less challenging than they were in 2020 and 2021.”*

As for EIS and SEIS, the restrictions made to Entrepreneur’s Relief in 2020 may only now be demonstrating its real impact on CGT bills, having been delayed by Covid slowing the rate of business sales: As Business Asset Disposal Relief, the lifetime limit for qualifying gains of £10 million for disposals was slashed to £1 million from March 2020 and the result is many more people having to pay CGT at 20% rather than the 10% rate previously applicable. This can only make the CGT deferral available under EIS and 50% CGT exemption available under SEIS, more attractive.

The rules changes in SEIS implemented in 2023/24 which saw boosts to the amount investors can invest each year and to the amount investee companies can raise, as well as an increase in the age at which a company can raise through SEIS, which has improved the risk profile for investors, have also been credited with attracting new interest in the scheme. On top of that, there's been an emergence of a much more active secondary market for shares in the very early-stage companies SEIS nurtures with lots of headroom for developing value. This has been linked to a decline in public market confidence and valuation inflation over the last few years on the main markets.

There is plenty of headroom for new investors, with **Stewart-Lockhart** noting that, *"education remains a key challenge and many potential investors still aren't aware of the opportunities offered by the SEIS and EIS and what the tax reliefs are. For example, data from the UKBAA showed that 90% of female angel investors weren't told about the EIS by their financial adviser."*

She also points out that, *"when you look at the data from HMRC, something that is perhaps surprising is that more than 50% of individuals who invested through the EIS in 2022/23 invested £10,000 or less. This is interesting when you consider the type of person or client who is sometimes seen as a 'typical' EIS investor, often investing much larger amounts than this."* The same could be said of VCTs, where the average amount invested by an individual in the same year was around £37,000, although around one in six investments was of between £5,000 to £10,000.

Stewart-Lockhart goes on, *"For the last 3 years, roughly 40,000 people invested through the EIS each year and this is still a relatively small number of people. Whilst acknowledging that these are high risk investments, the figures, coupled with the fact that many individuals investing through the EIS [and VCTs] are investing £10,000 or less, suggest that there are, potentially, significantly more people who might like to consider investing through the EIS as part of a diversified portfolio than exists at present."*

Of course, Consumer Duty is another important issue when it comes to selection of the most appropriate solutions for clients, making it hard, if not impossible, to justify blanket disregard for any potential options and this is discussed later in this guide.

Ed Prior

Head of Investor Services

SFC

“ We're seeing the exit market heat up, especially with the emergency of the secondary market in the UK. This opens real opportunities for early-stage investors at the pre-seed stage, offering various exit options. Recently, we completed a part-exit with a 15x return multiple but retained 60% of the holding. This provided a liquidity event for our investors while allowing them to continue benefiting from the investment. Liquidity is crucial for investors due to the long investment horizon. Having multiple rounds of liquidity events is highly beneficial.

Sunil Shah

CEO

o2h ventures

“ Tax Efficient Investments such as S/EIS are very attractive to UK taxpayers, over the last few years we have seen strong flows into these structures. However, the 'higher for longer' interest rates have seen this cool more recently. We believe that higher taxes on the horizon and lowering interest rates could create significant demand.

Fred Soneya

Partner

HAATCH

“ I continue to see excitement in pre-seed and seed. More opportunities and more entrepreneurs are starting than I have seen before. The later-stage market seems flat but is starting to recover after a very slow 2022/2023.

Jonathan Prescott

Partner

praetura INVESTMENTS

“ We think it likely that the market for tax advantaged investments will continue to grow. One of the primary reasons being, in the planning environment, advisers have over the last 10 to 15 years become increasingly constrained as to how they can help clients achieve tax efficiency. In addition, there has been a growing understanding of the use and application of VCT, EIS (and BR qualifying investments). Large institutions are allocating more capital to private markets in a drive to enhance return for clients. We see VCTs as an interesting route to access private markets rather than simply a way to generate tax efficiency - the tax advantages are only an attractive ancillary benefit.

THE TAX CONTEXT

The Spring budget of March 2024 saw cuts to National Insurance that further reduced rates already dropped in the Autumn statement of November 2023, to 8% for the employed and 6% to the self-employed. Impacting around 28 million employees and over 2 million self-employed individuals who will benefit from annual savings.

According to the Office for Budget Responsibility (OBR) though, those tax cuts are small beer. In its Economic and Fiscal Outlook accompanying the Spring budget, the OBR stated:

> *"Between March 2021 and November 2022, almost all the main allowances and thresholds in income tax and national insurance contributions (NICs) were frozen rather than indexed to inflation, as is the default in nearly all cases, up to and including 2027-28. The Chancellor has subsequently announced personal tax cuts that are due to offset around a half of the resulting impact on the personal tax burden by 2028-29."*

The main culprits are the usual suspects – income tax and capital gains tax:

INCOME TAX

→ Over the last ten years, income tax has been the leading contributor to government coffers as the source of an average of almost one third of government income[1].

→ From 2021/22 the personal allowance has been fixed at £12,570 until 2027/28. If it was indexed during this period, it would have been £15,990 by 2027/28.

→ The higher rate threshold, also frozen at £50,270 from 21/22 to 27/28, would have been £64,190 by 2027/28 if indexed.

→ From 2023/24 the additional rate threshold was reduced from £150,000 to £125,140 and fixed until 2027/28.

[1] HMRC tax receipts and National Insurance contributions for the UK: Statistics table, HMRC, November 2023

Continue

→ The results, laid bare by two more OBR statements, are eye-watering and alarming for a very substantial number of individuals:

1

The Exchequer will receive *"£33.6 billion of revenue from freezing the income tax personal allowance and higher rate threshold since March 2021, relative to raising them by CPI."*

2

"By 2028-29, there are expected to be around 3.7 million more taxpayers overall, 2.7 million more higher-rate taxpayers, and 600,000 more additional-rate taxpayers than if all allowances and thresholds had been indexed to inflation, and the additional rate kept at £150,000."

→ Government analysis of adjustments to dividend tax allowance, which halved to £1,000 in 2023/4 and halved again to £500 in 2024/25 (representing a 90% reduction since 2017/18 when it was £5,000) estimated that this would affect 3,235,000 individuals in 2023/24 and 4,405,000 individuals in 2024/25. Around 54% of those with taxable dividend income would be affected by this measure in 2023/24, rising to 73% in 2024/25. By 2027/28, the measure will lead to an increase of close to £1bn in Exchequer receipts.

CAPITAL GAINS TAX

→ The Annual Exempt Amount of capital gain (AEA) that could be made before capital gains tax applies was reduced to £6,000 in 2023/24 and to £3,000 in 2024/25 (representing a 75% drop since 2022/23 when it was £12,300): As a result, according to HMRC analysis, it's estimated that for 2023/24 around 500,000 individuals and trusts per year could be affected, increasing on a cumulative basis to 570,000 in 2024/25 when around 260,000 individuals and trusts are expected to be paying CGT for the first-time.

→ By 2027/28, this measure is projected to boost Treasury coffers by £440m.

→ There's an exception to the freezing of rates with the cut in the higher rate of capital gains tax on residential property disposals from 28% to 24% announced in the Spring budget 2024. However, the lowered rate is expected to bring forward some qualifying property disposals and to have a small but permanent positive impact on the level of property transactions. As a result, by 2028/29, there's only a small net cost small net cost of £4m to the Treasury.

Continue ▶

- Tax as a share of GDP is forecast to rise to 37.1% in 2028-29, 4.0% of GDP higher than the pre-pandemic level . This has been called "the highest tax burden for 70 years." So, there are significant drivers fuelling the search for ways to mitigate rising personal tax bills across a sizeable cohort, including higher earners, of the UK population.

- Recent comments from those in power suggest meaningful tax cuts in the near future are unlikely and that the freeze on income tax thresholds will stay in place until 2028.

"The Institute for Fiscal Studies confirmed last year that the tax take, as a percentage of national income, was at its highest since the 1940s. This is in part due to the freezing of income tax thresholds. Based on the state of the public finances and the demands on the public sector, this is unlikely to change much unless economic growth rapidly increases. A high level of taxation, especially income tax, can only bolster the appeal of VCTs as tax-saving products." - **Nick Britton**, Research and Content Director, the Association of Investment Companies.

Sunil Shah

CEO

o2h ventures

"It is inevitable that the Labour government will raise taxes given what it has labelled the unexpectedly poor state of the country's finances. Undoubtedly, an increase in taxes, coupled with a decrease in interest rates which is likely will have a positive effect on the demand for tax-efficient investments by high quality fund managers.

ALTERNATIVES IN THE ALTERNATIVES MARKET

Summary of what SEIS, EIS and VCT can do from a tax perspective

	Enterprise Investment Scheme (EIS)	Seed Enterprise Investment Scheme (SEIS)	Venture Capital Trust (VCT)
Annual maximum investment eligible for tax reliefs	£2,000,000 (where anything above £1,000,000 is invested in a knowledge-intensive company)	£200,000	£200,000
Income Tax relief	Up to 30% of the value of the EIS qualifying shares subscribed for	Up to 50% of the value of the SEIS qualifying shares subscribed for	Up to 30% of the value of the VCT shares subscribed for
Capital gains tax free growth	100% CGT exemption on EIS qualifying shares sold at a gain (provided income tax relief has been claimed and not subsequently withdrawn on the EIS shares). Gains exempt after 3 years and relief applies to unlimited gains	100% CGT exemption on SEIS-qualifying shares sold at a gain (provided income tax relief has been claimed and not subsequently withdrawn on the SEIS shares). Gains exempt after 3 years and relief applies to unlimited gains	100% CGT exemption on VCT shares sold at a gain. No minimum holding period applies and and relief applies to unlimited gains
Capital Gains Tax deferral relief	Yes. 100% of a gain can be 'deferred' if it is invested in qualifying shares	No	No
Capital Gains reinvestment relief	No	Yes. A maximum of 50% of a chargeable gain can be treated as exempt from Capital Gains Tax, where all or part of the amount of the gain is reinvested in qualifying SEIS shares. Reinvestment relief is limited to half the amount reinvested.	No
IHT Relief	100% of the value of the EIS qualifying shares held for a minimum of 2 years at the time of death (or other chargeable event for IHT purposes)	100% of the value of the SEIS qualifying shares held for a minimum of 2 years at the time of death (or other chargeable event for IHT purposes)	No
Loss Relief	Losses (less the income tax relief) can be offset against other capital gains in the year of the loss and any excess can be carried forward. Losses can also potentially also be offset against income tax in the current or preceding tax year	Losses (less the income tax relief) can be offset against other capital gains in the year of the loss and any excess can be carried forward. Losses can also potentially be offset against income tax in the current or preceding tax year	No
Tax-free dividends	No	No	Yes. No minimum holding period applies

Continue

	Enterprise Investment Scheme (EIS)	Seed Enterprise Investment Scheme (SEIS)	Venture Capital Trust (VCT)
Minimum holding period	3 years from the acquisition date of the shares (however, if the company is not trading when the shares are issued, the period ends on the third anniversary of commencement of the trade)	3 years from the acquisition date of the shares (however, if the company is not trading when the shares are issued, the period ends on the third anniversary of commencement of the trade)	5 years from the acquisition date of the VCT shares
Eligible investee companies	They must be unquoted (however, the AIM market is not a recognised exchange for this purpose). Most trades qualify, however, there are a number of exclusions: Dealing in land, commodities, futures, securities or financial instruments (including investment activities), Dealing in goods other than normal retail or wholesale distribution, Banking, insurance, hire purchase, money lending, and other financial activities, Leasing, Receipt of royalties or licence fees, Legal and accounting services, Property development, Farming and market gardening, Forestry, Operating or managing hotels or residential care homes, Coal production, steel production and shipbuilding, All energy generation activities (from 6 April 2016)		

Ed Prior

Head of Investor Services

SFC

> "For SEIS specifically, the last year has been a year of renewal with rule changes that have increased the age at which a company can raise through SEIS, which has improved the risk profile for investors, and increased the amount investors can invest each year. These changes have brought a new energy to the market.

KEY DIFFERENCES BETWEEN SEIS, EIS & VCTS

All three of these government initiatives can allow an individual to make use of the tax reliefs while also gaining access to potentially high returns and portfolio diversification. There are many similarities but also differences to the rules and it's important to understand how they impact investments. The main differences, aside from those in the summary table, include:

Main variations: **VCTS** vs **SEIS/EIS**

- Investors in a VCT receive shares in that VCT which then uses the funds raised to invest in a portfolio of underlying VCT-qualifying companies. Investors in an EIS or SEIS 'fund' are not investing in a fund at all, but directly in the shares of SEIS/EIS-qualifying companies.
- Unlike SEIS/EIS, VCT investment cannot be carried back to previous tax years.
- With a VCT, income tax relief is claimed at the point at which the shares are issued by the VCT. This is also treated as the starting point for the minimum holding period. In an EIS or SEIS company investment, the minimum holding period starts when the shares are subscribed for and income tax relief can be claimed as soon as the company has issued an EIS3 certificate to the investor. This can push out timelines for claiming tax reliefs.
- VCT investors receive a single tax certificate to claim tax reliefs, whereas SEIS and EIS investors receive a tax certificate for each SEIS/EIS-qualifying company they invest in, which are likely to number between five and ten (if they use a specialist SEIS/EIS investment manager) which can make claiming the tax reliefs more time-consuming.
- From a risk perspective, the biggest difference between SEIS/EIS and VCT is that VCTs generally operate a much bigger pool of investee companies, giving increased diversification and limiting investment risk.
- VCTs are listed on a recognised exchange and hold more liquid assets than SEIS/EIS funds (at least 20% of a VCT's funds are not required to be invested in qualifying holdings), and therefore VCTs have increased liquidity.

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- VCT managers often offer share buyback schemes to enable divestment, but these are usually at a discount to the underlying asset value and are not guaranteed. VCTs' shares are not widely traded and they usually trade at a discount to their Net Asset Value (NAV). SEIS/EIS managers do not offer buy-backs. Investors should regard themselves as locked into the shares until the underlying company lists on a recognised stock exchange, achieves a trade sale, or the company is wound up. AIM listed EIS-qualifying shares have the potential for faster disposal.
- Generally speaking, VCT income tax relief is given before SEIS/EIS income tax relief and consideration should be given to optimising any claims made (for example, SEIS/EIS relief could potentially be carried back to a prior year, leaving just VCT income tax relief in consideration for a particular year).

Main variations: **SEIS** vs **EIS/VCT**

	EIS and VCT	SEIS
Annual investment limit (company)	£5 million in any 12-month period (£10 million for knowledge-intensive companies)	£250,000 (£150,000 before 6 April 2023)
Lifetime investment limit (company)	£12 million (£20 million for knowledge-intensive companies)	£250,000 (£150,000 before 6 April 2023)
Gross Assets of investee companies	£15 million immediately before the shares are issued	£350,000 (£200,000 before 6 April 2023) immediately before the shares are issued
Staff numbers of investee companies	Less than the equivalent of 250 full time employees (500 for knowledge-intensive companies)	Less than the equivalent of 25 full time employees
Age of investee companies	Not trading for more than seven years (ten years for a knowledge-intensive company) unless specific conditions are met	The company must be no more than two years old.

THE VARIOUS STRUCTURES / ACCESS ROUTES TO SEIS & EIS

Direct investment into a single SEIS or EIS qualifying company is possible but is very risky unless the investor is an expert in the business of the investee company and has the time and knowledge to assess the opportunity. It also makes diversification difficult or near impossible. This might be an option for angel investors.

Fred Soneya

Partner

HAATCH

> Diversification in SEIS & EIS investments is key, so investing via a Fund enables investors to build a portfolio of many companies over one or more tranches, providing great tax reliefs with well-balanced and exciting portfolios.

SEIS & EIS 'FUNDS'

When specialist investment managers are involved, the investment structure is usually a portfolio of five to ten qualifying companies, either in the form of a Discretionary Managed Portfolio or an Alternative Investment Fund (AIF). Tax reliefs are available based on the year of each investment into each underlying company.

Unlike the SEIS or EIS manager undertaking a discretionary managed portfolio, an AIF manager is not required to consider the specific individual needs of each investor when assessing potential investments.

In both structures, the SEIS or EIS manager must be FCA authorised, and an investor will be the owner of shares in the underlying companies, rather than owning shares or units in any fund. Shares are held on behalf of investors by a nominee. The investor is the beneficial owner of the specified shares.

As a result, these investments are not really into funds, even though this is how they are commonly referred to.

Continue

Investors must hold their shares for a minimum of three years in the companies which the Fund has invested in but the investment manager typically retains the right to sell the investors shares at any time, even within the minimum period. It is also likely that a suitable exit will not be available until five to ten years from the acquisition of the shares. Both purchase and sale of shares in the companies the fund invests in are at the discretion of the investment manager.

For regulatory purposes SEIS and EIS are exempt from being deemed Non-Mainstream Pooled Investment Vehicles (NMPI) and are excluded from the ban on the distribution of Unregulated Collective Investment Schemes (UCIS) to retail investors. SEIS and EIS funds are instead categorised as non-readily realisable securities (NRRS) and thus a form of Restricted Mass Market Investments (RMMI). As a result, despite changes to the rules in early 2023, they can continue to be promoted to ordinary retail investors.

SEIS and EIS funds are not regulated and the FSCS will not compensate investors in the event that an investee company fails. However, if the investor in an SEIS or EIS Fund has a claim against the FCA regulated manager, and their claim relates to protected investment business (e.g. the fund management) undertaken for their benefit, they can make a claim with the FSCS based on COMP 5.5. The same applies in the event of a claim against the IFA recommending the scheme, or if the IFA or manager were to fail.

Investors can take a complaint to the FOS about an IFA who recommends the schemes, or the FCA regulated SEIS or EIS manager, unless the investor has been categorised as an elective professional client (COBS 3.5).

Sunil Shah

CEO

“We are seeing strong deal flows into our SEIS and EIS funds for evaluation, better than we have ever seen before. There is a softening of valuations though we have not seen any major capitulation at the preseed and seed stage of biotech investing. Part of the stronger deal flow could also be due to a broader range of universities uncovering spinout opportunities and also willing to co-invest.

Continue

Fred Soneya

Partner

HAATCH

> Investing in SEIS & EIS funds is the best way to access SEIS & EIS deals. By investing in a fund like Haatch you can pool money together which results in a better seat at the table, increased deal-flow and diligence all whilst the fund manager does the leg work. We see thousands of deals a year to make a handful of investments; you just can't do that level of research and diligence as an angel investor.

Ed Prior

Head of Investor Services

SFC

> SFC is now on several panels, marking significant progress for SEIS use among advisers. However, being on panels is only half the battle. Most advisers are still relatively unaware of the scheme and its benefits for investors. This is a general awareness problem across the entire market, illustrated by the fact that only 10,000 people invest with SEIS each year out of over 600,000 classified as high net worth, all of whom could benefit from the tax relief opportunities of SEIS. This highlights a challenge but also an enormous opportunity to reach a largely untapped market. As awareness grows among advisers and individuals, we expect to see significant momentum build.

KNOWLEDGE-INTENSIVE APPROVED EIS FUNDS

→ There is no SEIS equivalent to the Approved EIS Knowledge Intensive Fund structure.

→ Investors in approved EIS knowledge-intensive funds are entitled to the same tax reliefs as those in 'unapproved' funds (i.e those that aren't HMRC approved). The shares in which the fund capital is invested are subscribed for by, issued to and held by the manager, acting as nominee of each individual investor. The investor is 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.

Continue

- Tax reliefs are available based on the year the fund closes (even if the underlying investments are actually made in a later year) or the year previous to the fund closing, giving certainty regarding what years the tax reliefs can be applied to.

- An 'approved' EIS knowledge-intensive fund is focused on directing capital to knowledge intensive companies.

- Knowledge-intensive companies (KICs) - those carrying out high levels of research and development (R&D) and creating significant intellectual property or with a high proportion of skilled employees - are subject to more generous EIS limits and restrictions, to give them more time and money to build their business.

- Regardless of which of these structures is used, the adviser must determine whether an investment into unlisted securities is suitable for their client.

THE VARIOUS STRUCTURES / ACCESS ROUTES TO VCT

A Venture Capital Trust is a company (like an investment trust) that has been approved by HMRC and invests in, or lends money to, unlisted companies.

The VCT though, is a listed company in its own right that pools together money from investors and uses it to buy stakes in VCT qualifying companies. VCT shares are traded on the London Stock Exchange. Investors are shareholders of the VCT itself (not customers of the fund management company as is the case with open-ended funds).

VCTs are closed-ended investment companies that are also classified as Alternative Investment Funds (AIFs) and retail investment products.

The closed-ended structure of VCTs enables the VCT fund manager to take a long-term view and invest in less liquid assets than open-ended structures would normally do, as they do not have to worry about selling assets to meet redemptions.

VCTs can also retain some of their profits and pay them out later, which can allow VCTs to "smooth" dividend income.

VCT SHARE OFFERS

Although all VCTs have the same structure and their investments are governed by the same rules, there are TWO common types of VCT:

1 GENERALIST

The most common type of VCT where VCT managers keep their options open by not specialising in one type of asset and investing in any VCT qualifying trades that it deems suitable across a range of sectors. Predominantly investing in unquoted companies (excluding companies listed on AIM), the investee companies are not generally correlated to any public markets. One disadvantage, though, is that unquoted companies will not reach the liquidity levels offered by AIM.

Continue

2

AIM

AIM VCTs focus on shares listed on the Alternative Investment Market. They can benefit from higher liquidity levels than their unquoted counterparts and the publicly available information and analysis of AIM companies, which makes due diligence easier and allows for higher diversification through more investees. But more numerous shareholders mean VCTs are unlikely to be the dominant shareholder.

VCT offers also vary in terms of the share class for which investors can subscribe. The share class options are:

- A new VCT: In which legacy issues or costs associated with an existing VCT or share class can be avoided
- An existing share class in an existing VCT: An investor may have immediate access to an existing portfolio of companies, although it is important to check when dividends become payable to the client.
- A new share class in an existing VCT: The investor will not be able to access an existing portfolio of companies or their returns, but could be informed regarding the success or otherwise of the manager, even if there is no guarantee that it will be repeated in future.

Like SEIS and EIS, VCTs have a specific statutory exemption so they are not deemed to be Non-Mainstream Pooled Investment Vehicles (NMPI) and can continue to be promoted to ordinary retail investors.

Generally, a shareholder does not have access to the FSCS or FOS to complain about an investment into a VCT or a VCT manager. However, there may be limited instances where this is possible depending on the specific context. An investor is likely to need to take legal advice if they wish to explore this.

An investor may claim through FSCS or FOS in relation to a VCT when the IFA that advised them gave them faulty advice or in the event of it not being able to meet liabilities of investors and a claim is upheld.

Continue

VCTS & ISAS

It is possible to transfer an existing ISA to a VCT ISA. No new cash investment is needed to fund the investment. Alternatively, investors can set up a new ISA by investing directly in a VCT ISA. In both cases, the investor can still benefit from 30% VCT income tax relief on the investment, subject to the annual maximum.

While there would be no change to the tax position for those who subscribe to the VCT within the annual maximum (currently £200,000), investing an excess of up to £20,000 in the same tax year in a VCT ISA would theoretically enable an investor to subscribe more than the VCT annual maximum and receive tax-free dividends and growth on the additional level of the investment held within the ISA. However, these tax benefits would come by way of the ISA rules and not VCT qualification. Consequently, no up-front 30% income tax relief would be available on the additional £20,000 as ISAs do not offer this.

This means that adding VCT shares to an ISA is something to be carefully considered. VCT shares are high-risk and there is no requirement to use high risk shares within an ISA to achieve the tax reliefs.

EXAMPLES OF WHEN SEIS MIGHT BE A BETTER SOLUTION FOR A CLIENT AND WHY

Since SEIS targets seed stage companies that are at an earlier stage of development than EIS or VCTs generally target, greater income tax breaks are available to SEIS investors, but those investors need a higher appetite for risk and tolerance for loss. They could be particularly attractive to investors with a large income tax bill who are looking for explosive growth opportunities as, the earlier the investment stage, the lower the equity costs. However, this may also mean a longer development journey until exit so they are prepared for a longer investment horizon. An SEIS investment could also be appealing to investors with capital gains tax liabilities they want to reduce by 50% rather than just defer (as available through EIS).

Outside of tax and investment gains, some of those investing in very early-stage companies, especially those who are founders themselves, are keen to support others on the same journey.

However, of course, suitability depends on the specific circumstances of each individual client.

Stephen Jones: *"Normally if income is required the VCT is the obvious solution. Capital growth, the EIS is foremost, but for a combination of capital growth and CGT elimination/deferral, I look at SEIS."*

There are some circumstances in which it may be preferable for a client to invest through SEIS rather than EIS or VCT, including:

SEIS CAPITAL GAINS REINVESTMENT RELIEF

A client has sold a rental property that they never lived in for £120,000, making a capital gain of £40,000. He wants to extinguish the resultant £9,600 tax liability (he's an additional rate taxpayer, so the calculation is 24% of £40,000) as soon as possible rather than having a deferred liability hanging over him as would be the case if he reinvested the gain into EIS-qualifying shares.

Instead, he reinvests the £40,000 gain into SEIS-qualifying shares. He claims £20,000 upfront income tax relief against income tax liabilities in the year of and year previous to the SEIS investment. The CGT on the gain is reduced by 50%, cutting it to £4,800. He has his full £3,000 exempt amount remaining for that year and uses it to reduce the liability to £1,800.

Given the income tax saving, he is happy to pay off that remaining liability out of his savings.

Ed Prior

Head of Investor Services

> SEIS investors target companies within their first three years of trading when valuations are at their lowest but the risk is highest. We mitigate this risk by building large, diverse portfolios of startups with the potential to deliver outsized returns. This approach allows us to absorb inevitable losses and still drive significant value for our investors through the select few that generate the highest returns. For advisers, its crucial to assess the investing strategy, track record, and team when choosing the best SEIS fund for them and their clients.

EXAMPLES OF WHEN EIS MIGHT BE A BETTER SOLUTION FOR A CLIENT AND WHY

EIS offers solutions that are generally most appropriate for experienced and/or high earning individuals who are looking for tax planning methods married with high growth potential and conventional portfolio diversification opportunities. They are also able to commit funds for a five-to-10-year term, with a high-risk appetite and tolerance for loss of the capital they invest into EIS.

EIS offers the potential for larger investment amounts than SEIS or VCT and therefore higher tax relief. That high investment allowance and qualification for Business Relief means that EIS can be a useful facility for retirement and estate planning. The CGT deferral capability can also be compelling.

As ever though, suitability depends on the specific circumstances of each individual client.

There are some circumstances in which it may be preferable for a client to invest through EIS rather than SEIS or VCT, including:

Clients looking for tax-free growth with a substantial safety net

While no CGT is due on the growth in value of EIS-qualifying shares, where a loss, rather than a gain is achieved, income tax relief and loss relief can combine to provide a substantial cushion and that is without taking into account the impact of the tax-free gains and CGT deferral.

The following are dependant on the investor having sufficient income tax or capital gains tax liabilities against which the reliefs can be claimed.

EXAMPLE:

LOSS RELIEF CALCULATION Income tax (45% higher rate taxpayer)	
£100,000	Initial investment
£31,500	45% x £70,000 (initial investment less income tax relief claimed) to offset against income tax bill
£61,500	Total reliefs claimed (£30,000 income tax + £31,500 loss relief)
£38,500	Overall loss of capital after reliefs

Continue

LOSS RELIEF CALCULATION Income tax (45% higher rate taxpayer)	
£100,000	Initial investment
£14,000	20% x £70,000 (initial investment less income tax relief claimed) to offset against capital gains tax bill
£44,000	Total reliefs claimed (£30,000 income tax + £14,000 loss relief)
£56,000	Overall loss of capital after reliefs

Clients looking to defer CGT liabilities, perhaps indefinitely
(with or without using CGT annual exempt amount)

Selling assets can trigger capital gains, including very commonly, property sales. Those gains can be extinguished altogether if the gain remains reinvested into EIS qualifying shares at the time of the investor's death.

EXAMPLE:

In January 2025, Brian makes a chargeable gain of £25,000, generating a CGT liability above the 2024/25 CGT annual exempt amount of £3,000. Brian reinvests this chargeable gain in an EIS fund one year later and the capital gains tax bill of £5,000 is deferred. The shares are sold in August 2029 when capital gains tax becomes payable on the original amount deferred.

Capital gain amount invested (January 2026)	**£25,000**
After income tax relief of 30% claimed	**(£7,500)**
Capital Gains Deferral (assuming CGT at 20%)	**(£5,000)**
Net cash outlay for investment	**£12,500**
Shares Sold August 2029	
Deferred gain from 2025/26 comes back into charge 2029/30	**£5,000**
Tax payable on deferred gain at 20%	**(£5,000)**

If the original £25,000 gain is reinvested in EIS within three years of the disposal, the £5,000 liability could be deferred again until the shares are sold. If Brian still holds the reinvested EIS shares at death, the CGT liability is extinguished.

Continue

Mid-life clients (particularly those with potential health issues) **looking for more growth combined with the beginning of estate planning**

EIS can allow clients to kill two birds with one stone through the potential for high growth, but also the likely Business Relief qualification after two years of holding EIS-qualifying shares. While this won't take the investment outside of the estate for valuation purposes relating to the Residence Nil Rate Band (RNRB), it will reduce the applicable IHT on the BR-qualifying assets to zero. This can be the start of a conversation about estate planning and can be especially useful where one eye should be on that area if a client may be subject to a shortened life-span.

EXAMPLE:

Sarah invested £80,000 into EIS qualifying shares and held these for three and a half years prior to her death. During that period, they also qualified for Business Relief. As a result, when passed on to Sarah's beneficiaries an IHT saving on the EIS and BR qualifying shares is made of £32,000 (40% (the IHT rat otherwise applicable) of the value of the shares at the time of her death).

Clients looking to reduce their estate value while continuing to accumulate tax-free assets

Shares that qualify for EIS and which also qualify for Business Relief, can, after being held for a minimum of two years, be settled into trust without lifetime transfer costs, potentially dropping the estate value sufficiently to regain access to the RNRB (Estates valued at above £2,000,000 have their RNRB tapered away by £1 for every £2 by which they exceed £2,000,000). Once in the trust IHT relief applies as long as the trust holds the shares for the minimum of seven years or the death of the original investor.

EXAMPLE:

Brooke has an estate worth £2,300,000, including a house worth £750,000. They want to grow their assets tax efficiently and to start some IHT planning so they can pass on as much as they can to their children. They invest £300,000 into EIS qualifying shares and in three years-time, when they are valued at £340,000, move them into a discretionary trust.

Continue

After two years, their shares qualified for Business Relief. They waited a further year before settling them into a discretionary trust.

- Business Relief qualification means they are not required to pay the £60,000 IHT that would apply to a Chargeable Lifetime Transfer into trust (20% of £300,000) as previous CLTs (e.g. gifts into discretionary trusts) made within the last seven years have used up Brooke's entire nil rate band.

- The £40,000 gain made since the acquisition of the shares is not subject to CGT as they claim EIS disposal relief.

- But, any growth or income generated by the shares under the ownership of the trust will be taxable as they are no longer EIS qualifying shares in the hands of the trustees (they are not newly issued)

- Brooke's estate value is reduced to £2million as the EIS and BR qualifying shares are in trust and outside their estate, meaning that the RNRB taper (which previously totalled £150,000, leaving them just £25,000 of RNRB relief available) no longer applies. As a result, the full £175,000 RNRB relief is available.

- If Brooke dies within seven years of making the gift into discretionary trust, there may be further tax to pay

EXAMPLES OF WHEN VCT MIGHT BE A BETTER SOLUTION FOR A CLIENT AND WHY

VCTs tend to appeal to investors who want broad exposure to early-stage UK companies to diversify their portfolio. For investors happy to take investment risk, the combination of upfront income tax relief and tax-free income can complement pension planning or regular investing alongside ISAs. VCT investors are able to commit funds for a five-to-10-year term and their risk appetite is likely to be high, although perhaps not as high as those keen to invest in SEIS. Tolerance for loss of the capital they invest into VCTs must also be high though and they should accept that they are forgoing loss relief. VCT investors can also potentially receive regular tax-free dividends if the portfolio does well, meaning it can function as a source of tax efficient income.

Because claiming EIS reliefs depends on the timing of deployment of investment funds into underlying investee companies, it may make sense to recommend a VCT ahead of an EIS where a client's primary objective is Income Tax relief in the current tax year.

Once again, suitability depends on the specific circumstances of each individual client.

There are some circumstances in which it may be preferable for a client to invest through a VCT rather than SEIS or EIS, including:

Clients seeking tax-free income

Tax-free dividends might appeal to those looking to top up general income, such as pensioners. Or those keen to achieve a tax-efficient recurring income to regularly gift to family, such as children at university, or pay ongoing costs, such as school fees. Alternatively, reinvesting tax-free dividends into VCTs can generate additional income tax relief while also compounding the capital value of a VCT investment.

Continue

EXAMPLE:

Salvador, an additional rate income tax payer, invests £150,000 in a VCT which targets a 4% dividend yield, payable from the third year of investment (2024/25).

VCT Dividend due:	**4% x £150,000 = £6,000**
Dividend tax due if the shares were not eligible for VCT:	**£2,164.25**

£6,000 dividends - £500 dividend tax allowance in the 2024 to 2025 tax year.
£5,500 taxable dividends x 39.35% applied to dividends above the additional rate tax allowance =£2,164.25

Clients looking for tax-free growth with a safety net

Where a loss, rather than a gain is achieved, where full income tax relief is claimed, up to 30% of the investment amount is protected. That is without taking into account the impact of the tax-free dividends.

But any loss made on the disposal of VCT shares within the annual permitted maximum investment of £200,000 cannot be used to offset gains made elsewhere when calculating an investor's CGT liability.

EXAMPLE:

Lisa subscribes for £120,000 of VCT shares and then sells them for £100,000 six years later.

What at first appears to be a loss is not, when income tax relief claimed is taken into account: 30% of £120,000 = £36,000, meaning the net cost of the investment was only £84,000.

Continue

Those looking to increase tax-efficient savings and income for retirement

While the lifetime tax-free pension allowance has been scrapped, there is still an annual allowance of £60,000. For those with lots of excess income annually – perhaps an annual bonus - who wish to ensure their retirement living standards match those of their working life, the tax reliefs available through VCT investments offer attractive, practical benefits.

EXAMPLE:

Julianne earns £360,000 per year and therefore, with her savings income, pays tax at the 45% additional rate. However, due to the tapered annual allowance Julianne is now restricted to just £10,000 annual pension contributions.

She invests £50,000 per year into a VCT for the next five years. In year six, she invests just the income tax reliefs and dividends from year 5. She reinvests her income tax relief to compound her investment amounts and her dividends at a rate of 4% per annum paid from the fourth year onwards.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Total Capital
Investment	£50,000	£65,000	£84,500	£109,850	£145,405 (incl, year 4 dividends)	£47,921.50	£502,676.50 (£250,000 investor capital + reinvested income tax reliefs and dividends)
Income tax relief	£15,000	£19,500	£25,350	£33,555	£43,321.50 (incl. £600 from year 4 dividends)	£14,376.45 (not reinvested)	
Dividends	0	0	0	£2,000	£4,600	£7,980	Dividends will build to £20,107.06 per year by year 9 (assuming no capital gain or loss)

Into retirement, her VCT dividends continue to be paid tax-free and any profits on the sale of her VCT shares will be exempt from capital gains tax.

Continue

Clients looking to extract money from a business tax-efficiently

VCTs can offer a tax-efficient way of extracting profit from a business. Business owners can take a dividend from their company and invest it into a VCT, with the upfront tax relief on a VCT being used to offset any dividend tax due.

EXAMPLE:

Samuel has his own company and draws a salary of £12,570 per year tax-free (up to the personal allowance). He tops this up with £55,000 of dividends. In 2024/25, the first £500 of dividends are tax-free as a result of the £500 dividend allowance. The next £37,200 is taxed at the basic dividend tax rate (£12,571 to £50,270) of 8.75% generating £3,255 of dividend tax. The next £4,730 is taxed at the higher dividend tax rate (£50,271 to £125,140) of 33.75% generating an additional £1,596.38 of dividend tax giving a total liability of £4,851.38.

He invests £16,200 of the amount withdrawn into a VCT and is able to claim £4,860 income tax relief covering the tax liability of the entire £55,000 withdrawal. That leaves Samuel £38,800 + £12,570 income immediately available (£51,370) + the reclaimed tax of £4,860 + an ongoing investment free of tax on any growth and potentially generating annual, tax-free dividends.

REMEMBER, though, that for some clients holding investments in SEIS, EIS companies and VCTs, might work as there is the potential for regular tax-free dividends from the VCT, and the potential for significant returns upon the exit or acquisition of SEIS and EIS portfolio companies.

Sunil Shah

CEO

o2h ventures

"I believe EIS, SEIS, VCT schemes all have equal potential for inclusion in a balanced portfolio. Their suitability depends more on the individual circumstances, appetitive risk and overall portfolio management. There is room for all three as part of a diversified and well-thought-through investment and savings plan. The increase in quanta allocation from £150k to £250k is a big positive for preseed and seed stage companies in raising the finance required to reach a value inflection point.

VCT EXITS

Investors can choose to sell their VCT shares at any point, although to retain the tax reliefs, they should not do this before having completed the five-year holding period. But there is a general consensus that VCT investors are likely to need to hold their shares for a five-to ten-year investment period for tax-free capital growth and/or income payouts via tax-free dividends to have generated sufficient benefits alongside upfront income tax relief to make exit sensible.

There are, however, difficulties when it comes to selling shares in a VCT: While a proportion of the underlying investee companies of the VCT may gain value and raise the value of the shares held in the VCT, the exit value of VCT shares is likely to be lower than their Net Asset Value at that time, particularly if the exit is achieved through a share buyback of the VCT itself.

This is because, although VCTs are listed on the Main Market of the London Stock Exchange and therefore technically investors can buy and sell their shares on the secondary market, the upfront income tax relief that makes up a valuable element of VCT shares is only available on newly issued shares. As a result, natural demand for VCT shares on the secondary market is limited and any shares sold on the open market will likely be made at a significant discount to the Net Asset Value (NAV) of the VCT to compensate for the lack of initial income tax relief.

The solution put in place by the Board of Directors for most VCTs is to offer to 'buy back' VCT shares from existing investors, albeit at a discount (usually 5-15%) to NAV. Not only does this substantially reduce potential tax-free capital gains on exit, but share buybacks are conducted at the Board's discretion, and therefore there can be no guarantees when, or even if shares will always be bought back by the VCT.

No wonder then, that **Stephen Jones**' view is that, *"proposing a client invests in any less liquid or even illiquid investment vehicle is madness without ensuring your client does not need access to the capital allocated to this space. It is imperative to begin with a detailed cashflow to understand and educate the client."*

Despite many VCTs having a good record of undertaking buy backs which are often planned for between two and four times per year, there is always the risk that the VCT decides to delay and/or suspend a share buyback. Some risks are related to practicalities associated with the running of the VCT, for example buybacks cannot be processed until a VCT comes out of a closed period. Other issues could be that a VCT may not have sufficient liquidity with which to undertake a share buyback or a buyback on the required scale or at the narrowest discount, and when there are unfavourable market conditions buybacks may also be suspended.

Nevertheless, some advisers have reframed this exit dilemma as an issue for client beneficiaries and much less relevant for the original investor and the objectives the VCT shares have been recommended to meet. They see VCTs as a long-term investment providing a sustainable dividend that's tax-free which is ultimately remains a tradeable asset. In fact, in the context of VCTs, some actually view access to liquidity, to some extent, as a bigger risk than restricted liquidity as it can take an individual out into an environment that isn't giving those stable, tax-efficient returns. The key though, is to ensure that from day one of the advice process, this is effectively communicated to the client.

This is one of the reasons VCTs can also be viewed as a useful complement to a pension, particularly for clients who have limited capacity for pensions contributions because of earnings, but feel uncomfortable with the amount they have in their pension. It may also be why the AIC's **Nick Britton** says that, *"although buy-back schemes are not guaranteed, they have a history of working well in practice, in part because clients mostly hold VCTs for the long term and demand for liquidity is moderate."*

Jonathan Prescott

Partner

"

The understandable challenge many advisers raise with EIS qualifying investments is the risk associated with smaller companies in addition to the lack of visibility on the investment time horizon. By comparison VCTs generally operate an annual share buyback policy and investors have the option to sell shares in the secondary market. Whilst these exit routes from VCTs are not guaranteed and usually come at a discount to the net asset value per share, they give investors some visibility on the investment time horizon. Exiting EIS investments has arguably become less predictable since the introduction of the risk to capital condition in 2018. We believe that there is an interesting opportunity for secondaries in the EIS market – the secondary market is currently small therein lies an opportunity.

SEIS/EIS FOLLOW-ON INVESTMENTS

Companies that qualify for SEIS funding may also qualify for EIS funding and vice versa and that means it's possible for an investor to invest in the same company and claim both SEIS and EIS reliefs. Of course, that might make a lot of sense where a company that has raised SEIS funding has done well and evidenced its ongoing potential.

It's not possible, though, if the company has already received EIS funding as it must raise SEIS funding first. What's more, SEIS and EIS funds cannot be raised on the same day although, in practice, many companies choose to raise both SEIS and EIS funding at the same time. They must, however, ensure that SEIS shares are issued first, and then EIS shares are issued at least a day later.

There is a school of thought that sees the changes to SEIS introduced in 2023/24 as drivers for a shift in the number of larger investors utilising SEIS.

Changes to SEIS 2023/24

- The maximum amount a company can raise under the SEIS has risen from £150k to £250k.
- Eligibility criteria is now more inclusive, with companies holding assets of up to £350k (compared with £200k) now being able to qualify for the SEIS.
- Companies that have traded for up to three years can now qualify for the SEIS (an increase from the previous two-year limit).
- Individual investors can now invest twice as much in SEIS shares in a single tax year (£200k up from £100k).

If that is the case, it could well provide a boost to EIS fundraising because of the follow-on funding opportunities from SEIS to EIS.

Continue

Fred Soneya

Partner

HAATCH

> "The increase to the SEIS limits makes the UK's (and probably the world's) best investment tax relief even better and Haatch were the first fund to take advantage of these, investing from the moment they were announced

When engaging with EIS follow-on funding, it's useful to know that the key risks of SEIS investments are broadly similar to those that apply to EIS investments, although generally, the earlier the investment stage, the lower the equity costs. Consequently, SEIS can offer potential for higher growth but also higher risk.

The same rules apply to EIS and SEIS in relation to excluded trades and the risk to capital rules apply to both schemes which also share the same Investment structures and regulatory classification and an application for Advance Assurance covers both EIS and SEIS.

Many of the conditions that investors must meet to obtain EIS relief are the same as those that apply to SEIS, although when it comes to the condition that an investor must not be connected to, or become connected to the issuing company at any time during the investment term, there are two important differences to the rules that apply to EIS:

1. Although, under certain circumstances, angel investors can qualify for EIS reliefs if they are unpaid directors of the EIS company they are investing in, in general partners, directors and employees are all ineligible as connected parties. But, for SEIS, there is no restriction on directors investing under the scheme, providing they meet the other investor tests.

2. For SEIS, the connected party conditions apply from the dates the company was set up, rather than from 2 years before the shares were issued, which applies to EIS.

The claim process and deadlines to make claims for SEIS income tax relief, SEIS CGT disposal relief and SEIS loss relief are the same as for their EIS counterparts. Business relief can also apply to potentially SEIS qualifying shares.

RECOMMENDING HIGH RISK ALTERNATIVE INVESTMENTS UNDER THE CONSUMER DUTY

Consumer Duty now obliges advisers to better service consumers by going beyond "default solutions" and taking a much more proactive route to good customer outcomes throughout the advice process.

In the recent past the FCA has slammed "unsuitable high-risk investments" and this is particularly notable in the context of growing regulatory concern over climbing levels of vulnerability. 2023 statistics released by the FCA[1] show that 9% of UK adults (4.8m people) hold investments that the regulator considers to be high-risk, which includes shares in unlisted companies. Of these, 55% (2.7m) have one or more characteristics of vulnerability or their appetite for investment risk is very low.

But that doesn't mean that there is no place for high-risk investments (which is how the FCA classifies SEIS, EIS and VCT) in the regulatory landscape of the Consumer Duty because compliance with the Duty hinges on both advisers and consumers having a good understanding of any product they are recommending/investing in. So, if an SEIS, EIS or VCT is potentially part of the solution that offers the best client outcome and the client understands how and why, the risk profile is not a valid excuse for not recommending it.

"For me, our obligation under Consumer Duty is unambiguous. A client needs to have the options explained and to not include a potential solution which may reduce one or more of their tax liabilities, whilst simultaneously providing portfolio diversification and a real opportunity to make money is bad advice. Obviously, the inherent risk and relevance to the client circumstance must also be covered."
- **Stephen Jones**, Financial Planner and Managing Director of Clear Solutions Wealth and Tax Management

In fact, the regulator has stated that, *"we do not expect firms to protect their customers from risks that they reasonably believed the customer understood and accepted."* Evidencing that comprehension and consent – always important in the advice process - is now even more critical.

[1] Consumer Investments Strategy - 2 Year Update, FCA, December 2023

Continue

Venture capital, could actually be viewed as a risk mitigator in some respects. The companies into which investment is encouraged by SEIS, EIS and VCTs are unlisted and therefore their success or otherwise is not closely correlated to the economy or stock markets. What's more, in its white paper, *"how much should your clients invest in venture capital?"* Hardman & Co took a standard asset allocation model, and investigated what happens when you add venture capital with no tax reliefs to a portfolio of quoted equities and bonds, without changing the risk profile and appropriate rebalancing. The net result was that 60/40 investors could improve expected returns which compound into meaningful additions to portfolio returns over time.

Despite the risk to capital condition which was introduced in 2018 and which slightly alarmingly requires SEIS, EIS or VCT investors to be at a significant risk that they stand to lose more than they stand to gain as a return – after tax relief, risk profiles do vary. For a seasoned adviser in this space, there are some key areas to look at to identify the risk profile and the potential risks: For **Sophie Haslehurst,** senior IFA at Integrity 365 who has over a decade's worth of experience in recommending EIS and VCTs, it's essential that advisers *"really drill down into the underlying investments and the providers in the way that we do with our more traditional investments."* She goes on, *"we need to make sure we're not ignoring areas simply because they're risky. There's still a target market for this type of investment."*

Of course, the tax-efficient arena is a specialist one that most advisers won't deal with on a day-to-day basis. That might lead you to think your client bank is not relevant for these investments, but shying away from them because of a lack of knowledge is unlikely to satisfy the regulator if they are clearly a part of the optimal solution. That's why engaging with investment providers and advisers who are experienced in these investments can be useful as a route to key knowledge exchange.

Given the ongoing nature of most client relationships, introducing the idea of a higher risk investment some time well in advance of proceeding is sensible as it gives them time to get comfortable with it and to fully understand how and what it is intended to achieve. In fact, within a risk management framework it's entirely possible and sometimes necessary, that, for a portion of a client portfolio, not having any losers isn't a useful goal because the only way to achieve that is by eliminating risk and risk avoidance is likely to result in return avoidance.

Hence, a client who has a relatively low appetite for risk overall, may still be suitable for the solutions SEIS, EIS or VCT can offer. This would mean that different tranches of money within a client's portfolio are looking to achieve different outcomes and as a result, are subject to varying degrees of risk. In this case, the client file needs to be very clear whether the attitude to risk and the capacity for loss recorded is for a particular tranche of money or for the client's overall assets. And, ultimately, clients must understand the possible outcomes regarding the product recommended, including the poor outcomes.

Continue

“ I always say to advisers, look out for 3 things; hidden fees on both investor & portfolio company side, investment team (entrepreneurs and operators with experience vs “fund managers” and portfolio company support strategy.

Fred Soneya

Partner

HAATCH

When it comes to foreseeable harm, firms are only responsible for addressing the risk of it when it is foreseeable at the time, considering what a firm knows or could reasonably have known at the time. But, a firm's obligation to avoid foreseeable harm applies throughout the customers journey and lifecycle. Advisers should fully document the rationale for any conclusions regarding what was and was not reasonably foreseeable and include evidence from the chosen product provider of the specific actions they are taking to attempt to mitigate those harms that are reasonably foreseeable.

In SEIS, EIS, VCT, the main risks that a client needs to understand at the outset are:

Foreseeable Harm	**Potential mitigation**
Client does not achieve the minimum holding period to achieve/retain the tax reliefs	For SEIS and EIS investments, the investment manager is likely to be in control of when shares are sold. At ongoing reviews with clients, advisers can remind them of the five-year minimum holding period requirement.
The value of an SEIS, EIS or VCT investment, and any income from it (where applicable), can fall as well as rise and investors may not get back the full amount they invest.	You should expect SEIS/EIS/VCT investment managers to detail how their investee company selection process aims to minimise this in terms of ongoing drivers of value of the company and if and how they can positively influence the running of the company
Tax treatment depends on individual circumstances and tax rules could change in the future	It's important to have a full understanding of your client's circumstances at investment and how they may evolve over the lifetime of the investment to ensure they remain eligible for the relevant reliefs. As for tax rules, the possibility of changes is beyond an adviser's control. However, implementation of tax changes usually comes with notice.
Tax relief depends on portfolio companies maintaining their qualifying status	SEIS/EIS/VCT investment managers should undertake ongoing monitoring of the qualification status of all investees.
The shares of unquoted companies may be harder to sell than those listed on the main markets of the London Stock Exchange	The buy-back options of VCT investment managers can be helpful and while managers of SEIS and EIS investments cannot have a pre-planned exit for each company they select for investment, they are likely to have a good idea of where exit opportunities lie to may have explored the options.

Continue

There will also need to be documentation to show what forseeable risks of harm have been identified, how they have been mitigated or understood by the client if they are unavoidable. Evidence of full client understanding of what they are entering into, how the product works, the risks and impacts of varying scenarios is essential. So consider recording conversations, take detailed notes of client discussions and advisers should verify a clients comprehension of the investment.

"The Consumer Duty should have no impact on whether a VCT is suitable for a client or not. If it was suitable before the Duty was introduced, it will be suitable today. Advisers can rely on the value assessments published by managers on behalf of VCTs. Their clients should understand the nature of VCTs in general terms, but this should not be a barrier given the wide range of information available (including from the AIC) that explains what VCTs are and the risks and benefits." - **Nick Britton**, Research Director of the Association of Investment Companies

Sunil Shah

CEO

o2h ventures

"We are increasingly seeing financial advisers recognise the importance of incorporating EIS/SEIS schemes into their clients' portfolios. They are becoming more engaged, with a growing emphasis on the credibility of fund managers and the importance of a strong track record.

WHERE TO FIND OUT MORE
Access to useful information sources

Enterprise Investment Scheme Association (EISA)
eisa.org.uk

The Association of Investment Companies (AIC)
www.theaic.co.uk

Venture Capital Trust Association
vcta.org.uk

British Private Equity & Ventura Capital Association
www.bvca.co.uk

HMRC, Venture Capital Schemes Manual
www.gov.uk

The British Business Bank
www.british-business-bank.co.uk

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