

Not Very Assuring! New Advance Assurance Procedures For Venture Capital Investments

Ken Moody points out some recent unhelpful changes affecting certain investors.

Changes to the procedures for applying for advance assurance (AA) for proposed enterprise investment scheme (EIS) and seed EIS (SEIS) investors are intended to deter 'speculative' applications but, along with the 'risk to capital' condition introduced by FA 2018, may also create a 'Catch 22' situation for some start-ups.

A 'Catch 22' situation

The main procedural change is that it is now necessary when applying for AA to identify the potential investors, which is where 'Catch 22' comes to mind as potential investors may not be willing to consider committing until AA is received.

The AA application is now completed online but needs to be printed, signed and filed together with supporting documents. The new application form asks for a few additional details and all boxes must be ticked, otherwise an error message appears. For example, one of the items of information requested is 'any' subscription agreement, so you have to tick that box and if there isn't one then you obviously can't append (as in 'yes, we have no bananas').

The accompanying guidance at www.gov.uk/guidance/venture-capital-schemes-apply-for-advance-assurance, which contains a link to the application itself, states:

'You'll also need to provide an explanation of how you meet the risk to capital condition, which may include the details of your potential investors.'

In fact, you have to tick the box stating that the names and addresses of prospective investors are provided. In the case of investments sought through fund managers or crowdfunding, it is not sufficient to simply give the names of the managers or platforms. It is necessary to provide evidence (e.g. letters, emails) that the fund manager has agreed to work with the company or the company 'has engaged with and begun the screening process with the crowdfunding platform.'

The 'risk to capital' condition

The 'risk to capital' condition (see Tax Insider, October 2018) is introduced as ITA 2007, s 157A in relation to EIS investments, and in almost identical terms at ss 257AAA and 286ZA in relation to SEIS and venture

capital trust investments. This requires that it is 'reasonable to suppose' that the company has objectives to grow and develop its trade long-term and that there is a 'significant risk of a loss to capital greater than the net investment return' (taking account of the income tax relief).

When deciding if the risk to capital condition is met, HMRC will look at the company's:

- sources of income;
- assets;
- structure;
- use of subcontractors;
- marketing of the investment opportunity; and
- relationship with other companies.

These factors are listed in the legislation at ITA 2007, ss 157A(3), 257AAA(3) and 286ZA(3). In an application for AA I recently assisted in under the new procedures, I went through the list commenting on the significance of each factor, resulting in the longest covering letter I have drafted for AA!

If the required information relating to the investors is not provided, HMRC will simply respond that the application has not been reviewed and will not be looked at until the further information has been received (within two months).

My understanding is that fund managers are generally reluctant to consider potential investments unless AA has already been obtained. Catch 22 again, it seems, though the situation may change since everyone will be in the same boat in future.

Practical Tip:

There appears to be no reason why, if even only one individual investor can be identified, AA may not be sought for *that* investment, provided that the company is a qualifying company and the money raised is to be used for a qualifying purpose. This is simply following the legislation, though AA would only apply to that investment and a further application or applications may be necessary for later investments.

It should be remembered that even though the new procedures require prospective investors to be identified, AA does not imply that any individual will qualify for relief, which was always the case.