# EIS And SEIS Applications: Not Quite 'Catch 22'

**Ken Moody** explains the implications of recent changes affecting applications for advance assurance in respect of enterprise investment scheme and seed enterprise investment scheme potential investments.

**The 'risk to capital condition' introduced by FA 2018 in relation to enterprise investment scheme (EIS) and seed EIS (SEIS) investments and the updated HMRC guidance concerning applications for advance assurance and compliance statements, create obstacles which require careful management.**

## Meeting the 'risk to capital' condition

The risk to capital condition (at ITA 2007, ss 157A(1); 257AAA(1)) is met if it is 'reasonable to conclude' at the time of the issue of the shares that:

(a) the company has objectives to grow and develop its trade in the 'long-term'; and
(b) there is 'significant risk' that there will be a loss of capital greater than the net investment return (taking account of the income tax relief).

The provisions at ITA 2007, s 157A(3) and s 257AAA(3) (a)-(g) then sketch out the circumstances by reference to which the above tests are applied, such as the company's intention to increase the number of employees or turnover.

## Advance assurance applications

The main procedural change for the purposes of applications for advance assurance (AA) is the need to identify potential investors, which is intended to deter 'speculative applications' (see HMRC's Venture Capital manual at VCM14045). This is what has been referred to by many as a 'Catch 22' situation since receipt of AA was often used to 'assure' potential investors that their investments were at least likely to qualify for relief.

For the purposes of the AA application, it was always advisable to attach a business plan and/or other documents giving details of the company's activities and what the money raised by the share issue would be used for, plus the other documents listed on form EIS/SEIS(AA), which covered both schemes.

The new form (completed online and then printed and posted or emailed) asks, in addition, for the names and addresses of the potential investors, details of the company's objectives to grow and develop its trade and, for EIS and venture capital trust (VCT) applications, an explanation of how the money invested will be used to develop and grow the trade. This information must be provided, or the application will not be accepted.

At a minimum, therefore, it is necessary to identify at least one potential investor (though the more the merrier, of course). However, provided it is clear that the company will be a qualifying company and provided that the information given is otherwise acceptable, the small company enterprise centre (SCEC) will have no reason to decline to give AA – always remembering that it covers only that share issue (see VCM14030). Once 70% of the money has been used or four months after the issue of the shares, whichever is earlier (for SEIS), or four months after the issue of shares (for EIS), the compliance statement may be completed.

## Subsequent applications

Assuming authorisation (to issue certificate SEIS3/EIS3 to the investor) is given by the SCEC, this should assist applications for AA in relation to subsequent investments. HMRC states at VCM14045 that where the company has successfully raised investments under a scheme, an application for AA in relation to subsequent investments will not automatically be rejected if details of prospective investors are not included (though this is certainly advisable as far as possible).

It may thus be possible to seek AA (for example) for investment via fund managers before the fund manager has accepted the company as a viable investment as required by VCM14045, though the business plan may need to be updated to show how the previous investment was used (VCM14040).

### Practical Tip:

As always with EIS/SEIS the devil is in the detail, and it is advisable to carefully study the legislation and the updated HMRC guidance in each case. In applications for AA or preparation of compliance statements which I have recently assisted with, I have set out in a covering letter or email how it is considered that the risk to capital condition is met as required by s 157A(1) or s 257AAA(1) by reference to each of the various circumstances (a) to (g) listed at s 157A(3) or s 257AAA (3) (to the extent relevant and by reference to the business plan or other information, as appropriate).