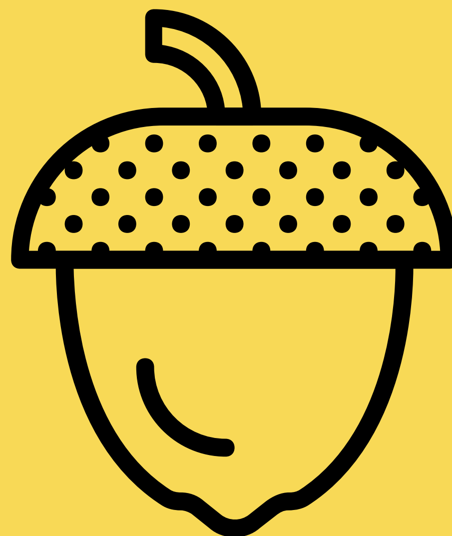
Teachers
Financial Planning



Investing in small companies

The different strategies and tax treatments for investing in small companies.

The Companies Act 2006 defines a small company as a business where the turnover is less than £6.5 million, the balance sheet is less than £3.26 million and there are no more than 50 employees.

However, different groups vary from this definition. The British Bankers Association for example, defines a small company as having less than £1 million in turnover and being run by a sole trader, partnership or as a limited company.

Irrespective of the different definitions of a small company, everyone is in agreement that they can offer excellent benefits to investors.

Benefits of investing in small companies

There are a number of potential benefits associated with investing in small companies, including:

- better growth potential which could lead to an increase in value of the company and its shares
- opportunities for increasing dividends as the company grows
- the investment market is less crowded as many investors, both individuals and institutions, look to invest in AIM companies rather than smaller businesses
- the potential for mergers and acquisitions is increased and more straightforward with smaller companies. If a company is subject to a merger or acquisition an investor's stake in the business could increase in value.

There are 3 main tax schemes that an individual can utilise to invest in small companies. It should be noted that an individual can also invest directly or make use of other specialist smaller company funds.

Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) is a government-backed initiative which gives investors certain tax allowances if they invest in qualifying shares in companies in qualifying industries.

Investors in an EIS must retain their shares for a minimum of 3 years. The EIS is attractive to more hands-on investors as they are permitted to take an active role in running the business and be paid to do so.

Companies who qualify for investment under EIS are limited to companies with gross assets of less than £15 million prior to and £16 million after the investment. The company must also employ less than 250 staff.

Tax relief

Investors in an EIS company can expect income tax relief at 30% on the amount that they have invested.

The maximum amount of investment that relief can be claimed on is £1 million per annum. If certain events such as shares being sold within 3 years occur, the investor may lose their tax relief.

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When an investor sells their shares after 3 years they will not be liable for capital gains tax (CGT) as long as some income tax on the shares has been collected.

CGT may be deferred if some or all of the gain is invested into an EIS company within 1 year prior or 3 years after the gain was accrued.

Relief against CGT, and in some cases income tax, is also available for any losses which have occurred following the sale of EIS shares.

Our team can provide technical guidance on small company investing.

Seed Enterprise Investment Scheme

The Seed Enterprise Investment Scheme (SEIS) helps early-stage small companies raise equity finance by offering tax reliefs to individuals who invest in them by purchasing new shares.

Shares eligible for SEIS tax relief are those issued on or after 6 April 2012.

The SEIS scheme recognises that new small companies may experience problems attracting investors, hence the tax reliefs offered are higher than other schemes.

The condition for investors utilising SEIS is that the shares are held for 3 years from the date of issue.

If the shares are sold or the investor ceases to meet the qualifying conditions in order to use SEIS the relief will be reduced or withdrawn.

Tax relief

Income tax relief is 50% based on a maximum annual investment of £100,000. The relief is applied in the form of a reduced tax liability as long as the investor has the tax liability to set it against.

The relief is available for those with a shareholding that does not exceed 30% in such companies and can include directors investing in their companies.

Income tax relief may be claimed up to 5 years after the 31 January following the initial investment. There is a 'carry back' facility which permits all or part of the cost of the shares purchased in 1 year to be considered as if they were purchased the preceding year and that year's tax relief is applied.

There are 2 CGT reliefs available to investors using SEIS:

- **Reinvestment relief**, allows investors to treat 50% of a gain from 2015/16 as exempt from CGT provided that certain conditions are met
- **Disposal relief**, where shares in a SEIS company are disposed of after having been held for 3 years and certain criteria are met.

Get in touch before committing to any investments.

Venture Capital Trusts

A Venture Capital Trust (VCT) is an investment company much like ordinary investment trusts. The main difference is that a VCT has to invest a minimum of 70% of its assets in qualifying investments (companies that would qualify for investment using an EIS). EIS have to meet the same rules.

The majority of a VCT's income must be distributed to its investors in the form of dividends. A VCT has to have a range of investments and none of the investments should make up more than 15% of the value of its portfolio.

Tax relief

Investors in a VCT qualify for 30% income tax relief however the shares must be held for a minimum of 5 years. Individuals may invest up to £200,000 in a VCT in a single tax year.

Dividends from VCT investments are exempt from the higher rate of income tax (provided that the individual is over 18). The basic rate will still be payable unless this is covered by the £5,000 dividend allowance.

CGT is not due on any gains made from VCT investments and there is no minimum period that the investment must be held to access this relief.

Risks

VCTs are considered high risk investments because the companies they invest in are small, relatively new and as they are unlisted and unquoted on AIM. Selling the shares may prove difficult.

This is because they could be considered less attractive and potentially more profitable than shares in listed companies.

Similarly, investing in SEIS and EIS companies poses similar risks in that the investor must retain their investment for 3 - 5 years, they are illiquid, and the capital is returned when the investment is sold.

Investing in any of these schemes is arguably best suited to individuals who can afford to tie up their money for at least 3 - 5 years.

Contact us today about creating an effective investment strategy.

Important Information

The value of investments can fall as well as rise and you may not get back the amount you originally invested. Tax rules and allowances are not guaranteed and may change in the future.

Certain investments, such as EIS and VCT schemes, can be high risk and are not suitable for most investors. Specialist advice is essential to establish both eligibility and suitability for such schemes. Whilst EIS and VCT schemes may have significant tax benefits, the value of investments can fall as well as rise and you may not get back all, or even any, of the amount you originally invested.

This document is solely for information purposes and nothing in this document is intended to constitute advice or a recommendation. You should not make any investment decisions based upon its content.

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