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to succeed

Taxing Matters Handbook: Corporate Venturing Scheme

A guide to the tax relief for companies
investing in other companies



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Introduction

The Corporate Venturing Scheme (CVS) is a scheme allowing most trading companies - referred to here as investors.

- To claim corporation tax relief at 20% on qualifying investments by subscribing cash for minority shareholdings in 'small higher risk' trading companies - referred to here as issuers.
- To postpone chargeable gains ('deferral relief') on disposals of the shares.
- To claim to set an allowable capital loss on the sale of the shares against income of the accounting period in which the loss arises and accounting periods ending in the previous 12 months

The CVS applies to shares issued before 1 April 2010.

Issuers are limited to those with gross assets not exceeding £15m immediately before the investment and £16m immediately afterwards. These figures will change to £7m and £8m with the 2006 Finance Act.

Investment relief

Eligibility

An investor is eligible for investment relief (see below) in respect of an amount subscribed by it for shares in an issuer if:

- the shares (the 'relevant shares') are issued to the investor;
- the investor is a 'qualifying investor' (see below);
- the issuer is a 'qualifying issuer' (see below) in relation to the relevant shares; and
- the general requirements below are met.

Advance clearance is available for the last two conditions

Qualifying period

In general, the 'qualifying period' begins with the date of issue of the relevant shares and runs for three years.

If the money raised is used for a qualifying trade that was not being carried on by the issuer or a qualifying 90% subsidiary then the qualifying period begins on the date of issue and ends immediately before the third anniversary of the date of commencement of the trade (or the latest date if there is more than one trade).

Compliance certificate

The issuer issues the investor a 'compliance certificate' relating to the shares. It does so with the Revenue's authority and in the form they direct. The certificate confirms that, from the issuing company's point of view, the requirements for investment relief are for the time being met in relation to the shares.

The issuer provides the Revenue with a 'compliance statement' to obtain authority to issue the certificate.

A 'compliance statement' says that, from the issuing company's point of view, the shares meet the requirements for investment relief and have done so since the shares were issued.

A compliance statement cannot be made until, where relevant, the funded trade has been carried on for at least four months (or such shorter time as is specified). The statement must be made within two years after the end of the accounting period in which the shares were issued or, if later, two years after the trade starts.

Qualifying investor

The investor must meet the following requirements:

'No material interest' requirement

At no time in the qualifying period (see above) must the investor have a material interest in the issuer. A material interest means owning directly or indirectly, or having the ability to do so, more than 30% of:

- the 'ordinary share capital' of, or
- the voting power in,

the company or any 51% subsidiary

This test is applied widely.

'No reciprocal arrangements' requirement

The investor's subscription for the relevant shares must not be part of any arrangements which provide for any other person to subscribe for shares in a 'related company'. A 'related company' is a company in which the investor, or any other person who is party to the arrangements, has a material interest.

'No control' requirement

At no time in the qualifying period must the investor 'control' the issuer.

'No tax avoidance' requirement

The investor must subscribe for the shares for commercial reasons and not as part of a tax avoidance scheme or arrangement. This is a peculiar requirement and does not prevent an investor investing to obtain the reliefs.

Non-financial activities requirement

Throughout the qualifying period, the investor must:

- if a single company (i.e. a company which is not a parent company or a 51% subsidiary), exist wholly for the purpose of carrying on one or more 'non-financial trades'; and,
- if a group company, be part of a 'non-financial trading group' and either exist wholly for the purpose of carrying on one or more 'non-financial trades' or businesses other than trades or be the parent company of the group.

Rules exist to determine the purpose of the company's existence.

'Financial activities' include:

- banking, or money-lending, carried on by a bank, building society or other person;
- debt factoring, finance-leasing or hire-purchase financing;
- insurance;
- dealing in shares, securities, currency, debts or other assets of a financial nature; and
- dealing in commodity or financial futures or options.

A group is a 'non-financial trading group' unless its business consists, wholly or substantially, in the carrying on of trades other than non-financial trades (as above) and/or businesses other than trades.

Certain group activities are disregarded.

Requirement as to shares being a chargeable asset

The shares must be subject to capital gains tax in the hands of the investor immediately after they are issued to it.

Qualifying issuer

The issuer must meet the following conditions:

Unquoted status requirement

At the time of issue of the relevant shares, none of the issuer's shares, debentures or other securities must be listed on a recognised stock exchange or a 'designated' exchange outside the UK or be dealt in outside the UK by 'designated' means, and there must be no arrangements for such a listing or dealing.

If, at the time of issue, arrangements exist for the issuer to become a wholly-owned subsidiary of a new holding company by means of a share exchange, there must be no arrangements made for any of the new company's shares, debentures or other securities to be listed or dealt in as above.

Independence requirement

At no time in the qualifying period (see above) must the issuer be a 51% subsidiary of another company or otherwise under the control of another company or of another company and persons connected with it. No arrangements must exist at any time during that period providing that the company could become such a subsidiary or fall under such control (whether during that period or otherwise).

Individual-owners requirement

Throughout the qualifying period, 'independent individuals' must beneficially own at least 20% of the issued ordinary share capital of the issuer.

An 'independent individual' is one who is not, at any time during the qualifying period when he holds ordinary shares in the issuer, a director or employee of the investor or of any company connected with it or a relative (i.e. husband, wife, civil partner, forebear or issue) of such a director or employee.

Special rules apply if the individual dies.

Partnerships and joint ventures requirement

At no time in the qualifying period must the issuer or any qualifying subsidiary be a member of a partnership or a party to a joint venture where :

- a trade, by reference to which the trading activities requirement (see below) is met by the issuer, is being carried on, or is to be carried on, by the partners in partnership or, as the case may be, by the company or a qualifying subsidiary (see below) as a party to the joint venture;
- the other partners or parties to the joint venture include at least one other company; and
- the same person(s) is/are the beneficial owner(s) of more than 75% of the issued share capital or the ordinary share capital of both the issuer and at least one of the other partners/parties.

Qualifying subsidiaries requirement

At no time in the qualifying period must the issuer have a ‘subsidiary’ other than a ‘qualifying subsidiary’.

A ‘subsidiary’ of a company is any company which it controls itself or through connected persons.

A subsidiary is a ‘qualifying subsidiary’ of another company (the ‘relevant company’) if:

- the subsidiary is a 51% subsidiary of the relevant company;
- no other person has control of the subsidiary; and
- no arrangements exist whereby the previous conditions could cease to be satisfied (see further below).

Special rules apply for winding up, dissolution, going into administration or receivership.

Property managing subsidiaries requirement

The issuer must not have, at any time in the qualifying period, a ‘property managing subsidiary’ other than one which is its ‘qualifying 90% subsidiary’. For this purpose, a ‘property managing subsidiary’ is a qualifying subsidiary (see above) whose business consists wholly or mainly in the holding or managing of land or any property deriving its value from land.

A subsidiary is a ‘qualifying 90% subsidiary’ if:

- the issuer possesses at least 90% of the issued share capital of, and the voting power in, the subsidiary, and is beneficially entitled to at least 90% of the assets available for distribution to shareholders on a winding-up etc. and of the profits available for distribution to shareholders;
- no other person controls the subsidiary; and
- no arrangements exist for the previous conditions no longer to be satisfied (though see also below).

Special rules apply for winding up, dissolving, going into administration or receivership.

Trading activities requirement

Throughout the qualifying period, the issuer must meet the trading activities requirement, which is as follows.

- If the company is a single company (i.e. neither the parent company of a group nor a subsidiary), it must exist wholly for the purpose of carrying on one or more qualifying trades (see below) and must actually be carrying on such a trade or preparing to do so.
- If the company is a parent company, the business of the group (treating the activities of the group companies, taken together, as a single business) must not consist wholly or substantially in any ‘excluded activities’, and at least one company in the group must satisfy the above trading activity requirement for a single company.

If a company satisfies the trading activities requirement because it is preparing to carry on a qualifying trade, the company must start the trade within two years after the issue of the relevant shares.

Qualifying trades

A trade is a qualifying trade if:

- it is carried on wholly or mainly in the UK;
- it is conducted on a commercial basis and with a view to profit; and
- it does not consist wholly or substantially in the carrying on of any ‘excluded activities’ (see below).

‘Substantial’ is not defined, but the Revenue accept that under 20%, based on any reasonable measure (usually turnover or capital employed) is not substantial.

Activities of research and development intended to lead to a ‘connected qualifying trade’ are treated as a notional qualifying trade. However, preparing to carry on such activities is not treated as preparing to carry on a qualifying trade.

A ‘connected qualifying trade’ is a qualifying trade carried on either by the company carrying out the research and development or, where applicable, by another member of the group.

Excluded activities

The following are excluded activities:

- dealing in land, commodities or futures, or in shares, securities or other financial instruments;
- dealing in goods otherwise than as an ordinary trade of wholesale or retail distribution;
- banking, insurance, money-lending, debt-factoring, hire purchase financing or other financial activities;
- leasing or receiving royalties or licence fees;
- providing legal or accountancy services;
- property development;
- farming or market gardening;
- holding, managing or occupying woodlands, any other forestry activities or timber production;

- operating or managing hotels or comparable establishments (including guest houses, hostels and other establishments whose main purpose is to offer overnight accommodation with or without catering) or property used as such;
- operating or managing nursing homes or residential care homes (both as defined) or property used as such;
- providing services or facilities for any business consisting to a substantial extent of the above activities and carried on by another person, where a person has a controlling interest in both that business and the business of the provider company.

General requirements

The shares

The relevant shares must be ordinary, fully paid up, shares and must be subscribed for wholly in cash.

Shares are not fully paid up if there is any undertaking to pay cash to any person at a future date in respect of the acquisition of the shares.

Use of money raised

80% of the money raised by the share issue must be used for the purposes of a 'relevant trade' within 12 months after the issue and must be wholly so used within 24 months of the issue.

If the trade starts after the issue these periods run from the start of the trade.

Using the money to prepare to carry on a trade (other than a notional trade of research and development - see above) is equivalent to using it for the purposes of a trade.

Special rules apply where the money is used to fund research and development.

No pre-arranged exits

The arrangements under which the relevant shares are issued to the investor (including certain connected arrangements) must not provide for:

- the eventual disposal by the investor of the relevant shares or other shares or securities of the issuer;
- the eventual cessation of a trade of the issuer or a person connected with it;
- the eventual disposal of all, or a substantial part of, the assets of the issuer or of a person connected with it; or
- partial or complete protection for investors against the normal risks attaching to the investment (other than commercial arrangements merely protecting the issuer and/or its subsidiaries against normal business risks).

No tax avoidance motive

The relevant shares must be issued for commercial reasons and not as part of a tax avoidance scheme or arrangement.

Advance clearance

A potential qualifying issuer may apply to the Revenue for an advance clearance notice in respect of an issue of shares.

An application must contain particulars, declarations and undertakings as required and must disclose all material facts and circumstances.

Within 30 days after receiving an application (or within 30 days after an 'information notice' is complied with), the Revenue must either issue an information notice (or further information notice), issue an advance clearance notice, or refuse the application.

An information notice requires further particulars to be provided within a given time, not being less than 30 days. If the applicant fails to comply timeously with an information notice, the Revenue need not proceed further with the application.

An advance clearance notice states that, on the basis of the details provided by the applicant, the Revenue are satisfied that, at the time the shares are issued, the requirements relating to the issuing company will be met (or, in the case of a requirement that can only be met in the future, will for the time being be met).

If the shares in question are issued before the advance clearance notice is given or the application refused, then again the Revenue need not proceed further.

Disposal

Where, during the qualifying period (see above), the investor disposes of any shares to which relief is attributable and which it has held continuously since their issue, relief is withdrawn or reduced.

However, certain reorganisations of the company's shares do not count as a disposal.

Value received by investor

Unless the investor receives replacement value, if in the period beginning one year before the issue and ending at the end of the qualifying period the investor 'receives value', other than an 'amount of insignificant value', from the issuer, investment relief attributable to the relevant shares is withdrawn, or is reduced.

This also applies if arrangements exist for the investor to receive, or become entitled to receive, any value from the issuer at certain times, no amount of value received by the investor is treated as an amount of insignificant value.

A receipt of value covers the repayment of the investment by various means including indirect payments and loans.

Replacement value must derive from a limited source and be equivalent in value to the value recovered.

Investment relief may also be withdrawn if certain others connected with the investor receive value from the issuer.

Put or call options can also trigger a deemed disposal.

Set-off of allowable loss against income

Subject to the conditions below and making a claim, an allowable loss, on a disposal by the investor of shares may be set against the income (as an alternative to setting it against chargeable gains in the normal way).

- The shares must have been held continuously by the company from time of issue to time of disposal. If, during any period:
 - the company was deemed under the Taxation of Chargeable Gains Act to have disposed of and immediately reacquired the shares; or,
 - following a scheme of reconstructionit is not treated as having held the shares continuously throughout that period.
- The investment relief must not fall to be withdrawn (as opposed to reduced) as a result of the disposal.
- The disposal must be either:
 - by way of bargain at arm's length for full consideration; or
 - by way of a distribution on a dissolution or winding-up of the issuer; or
 - a disposal being the entire loss, destruction etc. of the asset; or
 - a deemed disposal because the assets are of negligible value.

The set-off is against income of the accounting period in which the loss is incurred. Any unrelieved balance, may be set against income of accounting periods ending within the 12 months immediately preceding the accounting period in which the loss is incurred.

Claims must be made within two years after the end of the accounting period in which the loss is incurred.

Deferral relief

Deferral relief is available if a chargeable gain would otherwise accrue to the investor:

- on a disposal of shares qualifying for investment relief immediately before the disposal and which satisfy the condition requiring shares to be held continuously from issue to disposal; or
- on the occurrence of a chargeable event under these provisions,

and the company makes a 'qualifying investment'.

A 'qualifying investment' is a subscription for qualifying shares on which investment relief is obtained under the CVS, other than shares issued by a prohibited company.

The qualifying shares must be issued to the investor within one year before or three years after the time the chargeable gain in question arises. If the shares are issued before the gain arises, they must have been held continuously by the investor from issue until the time the gain arises, and they must qualify for investment relief.

A prohibited company means either:

- the company whose shares are disposed of or, in relation to whose shares the chargeable event occurred; or
- a company which, when the gain arises or when the qualifying shares are issued, is a member of the same group as the company in the previous condition.

The following count as qualifying shares:

- any bonus shares, issued in respect of the qualifying shares and being shares in the same company, of the same class and carrying the same rights;
- any shares issued on a qualifying company reconstruction in exchange for qualifying shares.

Postponement of the original gain

On a claim by the investor, the whole or part of the chargeable gain can be deferred. The amount to be deferred is the lower of :

- the amount of the gain (or the amount remaining in charge after any previous deferral relief claim);
- the amount subscribed for the qualifying shares (to the extent that it has not been used in previous deferral relief claims); and
- the amount specified by the company in the claim.

The claim must be made within six years.

Deferred gain becoming chargeable

The deferred gain will become chargeable if:

- the investor disposes of the shares; or
- any other event gives rise to a withdrawal of, or reduction in, the investment relief attributable to the shares.

A part disposal of qualifying shares brings into charge a proportionate part of the deferred gain.

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