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Extension of Entrepreneurs’ Relief to Long-Term Investors

Recent changes to Entrepreneurs’ Relief, announced in the Budget, are aimed at encouraging investment in unlisted companies. It will be of interest to technology companies looking for outside funding, and to the individuals who invest in them.

Entrepreneurs’ Relief (“ER”) - which allows up to £10m of qualifying gains to be taxed at only 10% - has previously been available only to employees or directors who held more than 5% of a company’s shares and voting rights for at least 12 months.

Now, an extension of ER (known as Investors’ Relief) means that external investors who subscribe for new ordinary shares on or after 17 March 2016 and hold them for at least three years (and at least until 6 April 2019) will benefit in the same way. Critically, Investors’ Relief does not require a 5% minimum holding; however, it is also not available to employees or directors of the company.

New investors are still likely to prefer Seed Enterprise Investment Scheme (“SEIS”) or Enterprise Investment Scheme (“EIS”) reliefs which, when available, guarantee that any gain arising after three years will be entirely free from capital gains tax. However, the new ER rules will be attractive to companies that are unable to meet the strict SEIS/EIS conditions (e.g. in connection with how the funds raised must be spent) or are put off by the heavy administrative burden that SEIS/EIS creates.

The measure may therefore help to encourage further investment in larger, more-established companies that continue to seek investment despite no longer being eligible for EIS. Such investors will be even more likely to seek a return on investment through capital gains rather than dividend income.

The new rules would also enable individuals that wouldn’t benefit from SEIS/EIS (e.g. due to being otherwise connected to the business) to invest and secure a beneficial tax treatment on exit.

Investors’ Relief may also be of benefit to companies that wish to issue non-voting shares that would not qualify for EIS or SEIS reliefs, as these permit further finance-raising without the dilution of the founders’ control. Whether investors would be satisfied with such shares is another matter, and would depend upon their own investment goals.

Whilst the change is unlikely to have a major impact on start-up or early-growth-stage tech businesses that can benefit from EIS/SEIS, it should benefit technology businesses that may otherwise struggle to access external finance, and make them more attractive to investors.

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