



**TAX-EFFICIENT
STARTUP
INVESTING**



Don't invest unless you're prepared to lose all the money you invest.
This is a high-risk investment and you are unlikely to be protected if something goes wrong.

IMPORTANT NOTE

This guide, like the service Wise Investor offers, is for UK-domiciled sophisticated and high net worth investors.

It is not advice or a personal recommendation. This is a quick summary of a complex subject and does not cover every nuance. You should not make – or refrain from making – any decision based solely on the content of this guide. If you are unsure an investment is right for you, please seek professional advice. We have made every attempt to ensure the information in this guide is correct and accurate (April 2024), but cannot guarantee it.

**PLEASE REMEMBER, TAX BENEFITS DEPEND ON CIRCUMSTANCES. TAX RULES CAN CHANGE.
IF IN DOUBT, PLEASE SEEK SPECIALIST TAX ADVICE.**

INTRODUCTION

From creating the first chocolate bar to inventing ATMs and the world wide web, Britain has a rich, centuries-long history of innovation.

Since 2010, the UK has added one million businesses and has grown faster than France, Italy, Japan or Germany. In the last decade, we have become home to Europe's largest life science and technology sector, its biggest film and TV sector and its second largest clean energy sector.

Fast-growing firms contribute £1 trillion to our economy and employ 3.2 million people: they are the country's growth engine, the lifeblood of the economy.

A crucial factor to keep that engine running are the investments thousands of private investors make every year to help startups get off the ground and scale up.

And some of those investments have paid off handsomely.



THE POTENTIAL FOR OUTSIZED RETURNS

Investors who backed Britain's first digital-only banking unicorn Revolut in 2016 were able to realise returns of 19 times their original stake just two years later.

Early investors in health-focused food box delivery service Mindful Chef in 2017 made a return of 35 times their investment when the company was acquired by Nestlé in 2020.

Those who backed 'letterbox flowers' pioneer Bloom & Wild in 2015 were able to realise 18 times their investment in 2020.

The patience of early backers of investment platform Interactive Investor was rewarded when after over 10 years from the original investment, the company was acquired by abrdn for £1.5 billion.

More recently, when fashion brand ME+EM was acquired in 2022, it generated a return of over 16 times the original investment.

This potential for outsized returns is one of the reasons more and more investors are turning to investing in startups. Past performance is not a guide to the future.

As you can probably expect, though, it is not all plain sailing.

For every headline-grabbing success story, there will be many more companies that fail or languish. Reportedly, 60% of startups fail within the first three years.

So, when you invest, you must be prepared to lose some or potentially even all your capital. Moreover, unlike publicly traded stocks, direct investments in startups are illiquid. You can't simply sell your shares or easily value them, as there is no ready market for them. You have to wait until the company achieves an exit (e.g. goes public or gets acquired) to cash out your investment, which could take several years.

But there are ways to mitigate some of those risks.



GENEROUS TAX RELIEFS

Recognising the high risks, and to partly mitigate them, the UK government set up its venture capital schemes, offering generous tax incentives when you invest in startups.

These are Venture Capital Trusts (VCTs), and the Enterprise and Seed Enterprise Investment Schemes (EIS, SEIS) – you can read more on each of these later in this guide.

They all offer income tax relief at the point of investment (30% or 50%) and a host of other tax benefits. Remember: tax rules can change and benefits depend on circumstances.

The tax savings for investors could be substantial. HMRC estimates that in 2022/23 VCT investors altogether saved themselves £330 million, EIS investors £520 million and SEIS investors £95 million through the reliefs.

Tax relief plays a crucial part in the investment: it can amplify returns when things go well and somewhat soften the blow when things don't go to plan, though it does not eliminate risk altogether.



HOW COULD YOU MAXIMISE YOUR CHANCES OF SUCCESS?

There is a myriad of startup investment opportunities, all promising high returns. Some may be obviously destined for failure, others less so.

The key to a successful startup investment portfolio is likely to be threefold.

Firstly, diversify. Don't put all your eggs in one basket. You should spread the risk, so if any of the businesses fail, you have others to fall back on. A good startup investment rule of thumb is that out of 10 companies in a portfolio, one might deliver stellar returns, two or three might do ok and the rest (the majority) will fail or tick over. You just won't necessarily know which will do what, and of course they all might fail.

Secondly, take advantage of the generous tax reliefs available.

Thirdly, do your own research to help eliminate some of the lower-quality deals and isolate the more promising ones.

Ideally, before investing you should get to know each company, its management, as well as the challenges and opportunities of the market it operates in, at the very least. This can be very hard and time consuming, since the level of publicly available information on private companies tends to be very limited.

Sourcing good deals might also prove tricky for a private investor without an extensive network to get into the best deals. Moreover, an individual investor may struggle to meet in full early-stage companies' funding requirements, which can be in the multi £millions.

This is why many investors prefer to get exposure to startups by using a service that pre-screens the opportunities or through a fund (VCT, EIS or SEIS).

In both cases, the manager will have a due diligence process and investment rigour that may be hard for an individual investor to replicate. In addition, startups that are promising enough to attract investment could benefit from the funding and any accompanying mentorship, which in turn helps support growth. A Beauhurst survey found that only one in four startups successfully scale within their first five years: these were mainly ones that had received more equity funding than others.

In the following pages, we explain in brief how VCTs, EIS and SEIS funds work. We also cover how using a service like Wise Investor could help experienced investors build their own portfolio of pre-screened startups while maximizing their tax efficiency.

AT A GLANCE: HOW DO VCT, EIS AND SEIS TAX RELIEFS COMPARE?

VCTs	EIS	SEIS
Allowance	£200,000	£2,000,000
Income tax relief	Up to 30%	Up to 30%
CGT relief/deferral	No	Deferral
Tax-free income	Yes	No
Tax-free growth	Yes	Yes
IHT relief	No	After 2 years
Loss relief	No	Yes

Please note tax rules can change and benefits depend on circumstances. To retain the tax relief, you must hold the investment for at least five years (VCT) or three years (EIS and SEIS) and it must remain qualifying. EIS allowance includes knowledge intensive investments.

VENTURE CAPITAL TRUSTS

For those looking to invest in startups for the first time, a good place to start could be a VCT. A VCT is a company listed on the London Stock Exchange. Somewhat akin to an investment trust, it invests in a basket of private and AIM-quoted companies and has a professional fund manager. Established VCTs will typically be invested in between 30 to 100 businesses at any one time.

VCT investors get exposure to the whole portfolio, which is likely to also include the much more mature (and now lower risk) companies the VCT invested in earlier on. It's also worth bearing in mind that while now VCTs can only invest in newer, small companies, previous VCT rules were less strict and allowed investment in mature businesses, which if still in the portfolio could reduce risk.

Popular VCT managers include Gresham House (manager of several VCTs, including the Mobeus and Baronsmead VCTs), Octopus and YFM (manager of the British Smaller Companies VCTs). Successful VCT-backed startups include property portal Zoopla, fashion label ME+EM, vintage clothing marketplace Depop and leading electric vehicle charging infrastructure company Chargemaster.

WHAT ARE THE TAX BENEFITS OF VCTS?

When you invest in VCTs you can get up to 30% income tax relief. Invest £10,000, for instance, and you could get up to £3,000 back.

The maximum you can invest in VCTs each year with the benefit of tax relief is £200,000. Any returns from VCTs (normally paid as dividends) are tax free. Established VCTs typically aim to pay a 5% tax free dividend a year along with special dividends when they achieve successful exits, although neither are guaranteed.

The minimum holding period to retain VCT tax relief is five years.



ENTERPRISE INVESTMENT SCHEME

Companies that qualify for investment under EIS are at a similar stage and maturity to companies meeting the rules for new investment by VCTs. However, unlike a VCT, where you hold shares in the trust which invests in a pool of companies, with EIS you become a shareholder of the individual businesses.

There are two main ways to make EIS investments.

The first is to invest directly in single companies, deciding yourself which to back. Each single company investment lacks diversification. Get it right and the reward could be considerable, but inevitably some will fail. To help mitigate this, it might be wise to diversify and spread your EIS investments each year over a number of single companies.

The other is to invest into a portfolio of EIS opportunities chosen for you by a fund manager. Typically, a portfolio will invest in between five and 10 different early-stage businesses. Managers include Amadeus, Guinness, Fuel Ventures and Parkwalk.

Well known EIS-backed companies include marketing platform ContentCal, which was sold to tech giant Adobe; "letterbox flowers" pioneers Bloom & Wild, which returned EIS investors with up to 18 times their original investment; and food delivery service Pasta Evangelists, which was sold to Barilla in 2021 providing its EIS investors with a three and a half times return in three years.

WHAT ARE THE TAX BENEFITS OF EIS?

When you invest, you get up to 30% income tax relief. Invest £10,000, for instance, and you could get up to £3,000 back.

You can potentially invest up to £2 million a year through EIS (£1 million of which must be "knowledge intensive") and so receive up to £600,000 in tax relief. Any growth should be free of capital gains tax. EIS companies, due to their stage, do not typically pay dividends, and the returns come through capital growth, but any dividends would be taxable.

In addition, if you have any capital gains from the sale of investments made elsewhere, you can use EIS to defer those gains (and the subsequent tax liability), potentially indefinitely.

There are also inheritance tax benefits. Providing you hold the investment for at least two years and do so on death, it should be inheritance tax free.

Any losses can be written off against your income or capital gains tax bill. Indeed, if you are a top-rate taxpayer, even if your entire EIS investment is written off, because of the tax reliefs your effective loss could be as little as 38.5 pence in the pound.

To keep the tax benefits you must be invested for at least three years and the company must remain qualifying.

DIRECT INVESTMENT IN PRE-SCREENED STARTUPS

If you like the idea of putting together your own portfolio of startups, but don't have the time to source and review deals, there are services that could help.

There are local or regional angel networks scattered around the country, which may provide access to local or regional deals.

There are also crowdfunding platforms – marketplaces bringing together investors and companies seeking to raise capital, often under EIS.

PRE-SCREENED OPPORTUNITIES

Wise Investor offers a service that goes a little further: we give investors access to a pre-screened list of startups seeking funding.

We verify company details and we gather information about the management team. We see around 50 deals each month. Only a handful, around 2%, make it to our website.

We have a highly experienced team with extensive backgrounds in corporate finance, private equity and venture capital – a collective 50 years of investing experience.

We often co-invest alongside institutional investors – VCTs, EIS funds or other professional investors. This could help validate the investment merit of the opportunity. It might also make it easier for the company to raise funds in future, if needed, although this is not guaranteed.

We then look at the company's management, their experience, and previous successes (or failures), the market, and the financials. Finally, we try to make sure the valuation is reasonable, i.e. in line with the wider market and appropriate to the stage the company is at and the risks involved. As ever, the earlier the stage, the higher both the risks and potential returns.

WE DO THE GROUNDWORK TO SAVE YOU TIME

We make the findings of our review available online: as an investor, you still have to decide for yourself whether the opportunity is attractive enough to invest, but we do a lot of the groundwork to save you time (we don't give personal advice).

Example of private companies our investors have invested in through us are:

The Ralph – now the UK's second largest multidisciplinary specialist veterinary referral hospitals for small animals. Wise Investor EIS investors backed it from the outset: from the idea for a working hospital in 2017, to a rapidly growing and profitable business turning over £15.3 million in the financial year to 31 March 2023.

Flagstone – the UK's leading cash deposit platform, helping clients access multiple savings accounts from 59 UK banks through a single application. In 2022, Wise Investor investors joined previous backers Canadian pension fund OMERS and FTSE 250 Moneysupermarket.com Group. In March 2024, the company announced a £108 million (\$138 million) equity investment by Estancia Capital Partners, a US financial services specialist private equity firm. Under the terms of the deal, Estancia has taken a minority stake in the Flagstone business. The transaction provided investors with an opportunity for an early partial exit.

Kore Labs – an award-winning platform that enables large financial institutions fast track regulatory compliance. Founded and backed by industry veterans, the company has been revenue- generating since launch in 2019 and serves 10+ blue-chip clients across Europe.

After investment, we try to stay close to the businesses so we can keep our investors updated and support the company in its progress towards an exit. Typically we have information rights, Board Observer rights along with warranties and consent rights commonly found in investment agreements in early stage deals.

SEED ENTERPRISE INVESTMENT SCHEME

SEIS is very similar to EIS – you can invest directly into single company opportunities or into a portfolio of companies chosen by a professional manager. Popular SEIS managers on our website include Fuel Ventures, Haatch Ventures and SFC Capital.

The main difference is that SEIS invest in even smaller and typically younger companies than EIS so even more risky.

Successful SEIS-backed companies include Cognism, whose technology allows salespeople to prospect more efficiently and which is reportedly now worth \$450 million, and Onfido, which helps companies verify people's identities and is worth £100 million.

WHAT ARE THE TAX BENEFITS OF SEIS?

You could receive up to 50% income tax relief when you invest, so on a £10,000 investment you could get back up to £5,000 in tax relief.

You can also claim capital gains reinvestment tax relief of up to 50% on capital gains you have made from the sale of other investments or investment property. Using both reliefs combined means you could potentially claim up to £6,400 in tax reliefs on a £10,000 investment.

You can invest up to £200,000 a year into SEIS with the potential to claim up to £128,000 in tax relief.

As with EIS, any capital gains should be tax free. In addition, providing you hold the investment for at least two years and do so on death, it should be inheritance tax free.

If your investments don't work out, as with EIS, you can write off your losses against either your income tax or capital gains tax bill, which vastly reduces the risk. Indeed, if you are a top rate taxpayer using the maximum of all the SEIS tax allowances, even if your entire SEIS investment goes to zero, because of all the tax reliefs your effective loss could be capped to as little as 13.5 pence in the pound.

To retain the SEIS tax benefits, you must be invested for at least three years and the company must remain qualifying.

VCT CASE STUDY: ME+EM – PEMBROKE VCT INVESTMENT

Luxury fashion brand ME+EM was founded in 2009 by friends Clare Hornby and Emma Howarth.

They sought to create "flattering" and "functional" clothes with a timeless "wear-forever" appeal at an accessible price. Unlike many fashion brands, ME+EM designs and produces its collections in-house. The brand's sales are almost entirely online, although there are also eight store/concession locations. That helps it keep costs down while maintaining a top-quality product, which has attracted high-profile fans including Catherine, the Princess of Wales.

Pembroke VCT first backed the business in August 2015, investing a total of £956,000 over the next five years. In March 2022, the VCT sold its stake to VC firm Highland Europe for £15.4 million, a 16.1x return. Proceeds from the disposal were used to pay a 5p special dividend in July 2022. Past performance is not a guide to future returns.



EIS CASE STUDY: YASA MOTORS – PARKWALK KNOWLEDGE INTENSIVE EIS FUND III

YASA develops revolutionary compact, lightweight and powerful electric motors and controllers. The products enable vehicle hybridisation and electrification, especially where there is limited powertrain space.

The company supplies custom and off-the-shelf e-motors and controllers to automotive customers from its Oxford headquarters. YASA is a Ferrari Strategic Technology Partner and has supplied a custom electric motor for Ferrari's first hybrid vehicle, the SF90 Stradale, as well as the 296 GTB. YASA is also entering the aviation market and has partnered with Rolls Royce to break the speed record for electric flight.

Parkwalk first invested in YASA through a £1.8 million Series A funding round in August 2012 at a £5.7 million pre-money valuation. Since then, Parkwalk has supported the business through further funding rounds, most recently in August 2019, at a pre-money valuation of £72.5 million.

In July 2021 Parkwalk announced that YASA had been acquired by Mercedes-Benz. The sale delivered returns of between 2x and 6x, depending on the round, and returned £45m to Parkwalk investors. Past performance is not a guide to the future.

Please note, the companies mentioned in this guide are examples of successes. However, in reality, you should expect some failures.



DIRECT INVESTMENT CASE STUDY: THE RALPH

The Ralph is an independent, multidisciplinary, specialist veterinary referral hospital for small animals, based in Marlow, Buckinghamshire.

It provides 24-7-365 emergency and critical care (ECC), in addition to other specialist referral services for cats and dog referred by local vets. Opened in February 2019, The Ralph is the UK's second largest emergency and critical care referral centre. It now has more than 230 staff and in the 12 months to March 2023 saw 4,500 new patients.

Wise Investor investors backed The Ralph from the outset: from the idea for a working hospital, to a rapidly growing business turning over £15.3 million in the financial year to March 2023.

SEIS CASE STUDY: STARTUP FUNDING CLUB INVESTMENT IN COGNISM

Cognism's AI-based technology helps businesses generate genuine sales and marketing leads. The technology reportedly enables an impressive 5x increase in reach, 7x increase in conversion rate and 80% fewer calls needed for better results.

The company's lead-generation tools are used by over 1,000 businesses in 40+ countries.

SFC took part in Cognism's first funding round in 2017 through its SEIS fund, and followed on in 2018 through its EIS Fund. At the time of SFC's first investment, Cognism had recurring revenues of £4,500. In 2021 recurring revenues reached over \$11 million and the company featured in the LinkedIn Top Startups list for the third year in a row.

In January 2022, Cognism raised \$87.5 million in a deal led by American investment group Viking Global Investors, which valued the business at more than £200 million. SFC sold a little under half its SEIS stake in the business for a 43.2x gain. The EIS investment showed an overall gain of 9.2x, with realised proceeds equivalent to 2.8x the entire initial investment (December 2021).

VALUATION HISTORY OF THE COMPANIES MENTIONED ABOVE

ME+EM - VALUATION HISTORY.

DATE	VALUATION
August 2015	£3m
March 2017	£4.38m
October 2018	£6.49m
December 2020	£29.1m

Source: Beauhurst. The table above shows the company pre-money valuation at each funding round, as recorded by Beauhurst as at January 2024.

COGNISM - VALUATION HISTORY

DATE	VALUATION
December 2016	£370k
February 2017	-
April 2018	£5.88m
January 2019	£10.4m
July 2019	£20.8m
March 2020	£40.4m
March 2021	£59.6m
January 2022	£199m
December 2016	£255m

Source: Beauhurst. The table above shows the company pre-money valuation at each funding round, as recorded by Beauhurst as at January 2024.

YASA MOTORS - VALUATION HISTORY

DATE	VALUATION
July 2010	£1.86m
August 2012	£5.71m
January 2013	-
January 2014	£3.86m
May 2016	£10.6m
July 2017	£27.9m
February 2018	-
September 2019	£72.5m

Source: Beauhurst. The table above shows the company pre-money valuation at each funding round, as recorded by Beauhurst as at January 2024.

HOW WISE INVESTOR CAN HELP

If you would like to find out more about investing in startups – tax-efficiently through VCTs, EIS or SEIS – we can help.

Wise Investor is the UK's largest platform specialising in tax-efficient and alternative investments – more than 8,000 experienced investors have invested around £850 million to date through us (March 2024).

We give experienced private investors access to a broad selection of VCT, EIS and SEIS offers from all the key managers as well as offering a regular stream of our own pre-screened startups. We have regular investment opportunities on our website. Our clients have invested in everything from a state of the art 24 hour emergency veterinary hospital, The Ralph, to cash management platform Flagstone.

We make it straightforward to apply online for the investments you have chosen and provide you with an unparalleled level of impartial reviews, videos and information to help you decide whether to invest.

Importantly, when you invest through Wise Investor you normally get a better deal than investing directly with the provider. For instance, on many VCTs, in addition to an initial saving, Wise Investor investors benefit from annual rebates of up to 0.15% for the first three years.

WHAT OUR CLIENTS SAY

"Most investment platforms are like trying to see through muddy water, with Wise Investor you can see exactly what your investing in."

– Laura, March 2024

"Very good range of products available. Provides access to professional markets with commission rebates. Good summaries of available investments including complex ones such as SEIS funds."

– Mary, February 2024

"Easy to use and contact if required. My phone query was answered within seconds. Clear and informative website. Have used on several occasions."

– Anne, January 2024

"Phone answered in 1 ring, efficient security check, then my question was answered straight away ... brilliant"

– Mr Marsh, December 2024

RISK SUMMARY Estimated reading time: 2 min

The Financial Conduct Authority (FCA) classifies investments in non-readily realisable shares, such as S/EIS investments, as high risk due to the potential for losses.

What are the key risks?

1. Risk of losing your entire investment

If the business you invest in fails, you could lose 100% of your invested capital. The majority of start-up businesses do not succeed.

2. Limited protection if something goes wrong

The Financial Services Compensation Scheme (FSCS) does not cover poor investment performance in relation to claims against failed regulated firms. Check the FSCS investment protection checker on their website for more information.

The Financial Ombudsman Service (FOS) also does not provide protection against poor investment performance. However, if you have a complaint against an FCA-regulated firm, the FOS may be able to consider it. Visit the FOS website to learn more about their protection.

3. Illiquidity and long investment horizons

Even if the business you invest in succeeds, it may take several years to realize returns on your investment. Early exits are unlikely to be available.

The most probable exit scenarios are acquisition by another company or an initial public offering (IPO) on a stock exchange like the London Stock Exchange. These events are relatively rare.

Start-up businesses seldom pay dividends, so do not expect regular income from your investment.

4. Importance of diversification

Investing all your capital in a single business or type of investment is risky. Diversifying your investments reduces your reliance on any single investment's performance.

The FCA recommends investing no more than 10% of your total portfolio in high-risk investments (see the FCA's website for more information).

5. Potential dilution of your investment

Your ownership percentage in the business may decrease if the company issues additional shares. This could lead to a reduction in the value of your investment, depending on the company's growth.

These new shares may have additional rights that your shares do not, such as the right to receive a fixed dividend, which could further reduce your chances of getting a return on your investment.

For more information on how to protect yourself, please visit the FCA's website.

