

EIS

Enterprise Investment Scheme ("EIS") Overview - The following is a brief summary of the main features of the EIS– it is not a comprehensive explanation about all of the rules and details. It does not set out all of the rules or regulations that must be adhered to and should not be interpreted as the provision of tax, legal or financial advice. Users of the Portal are strongly recommended to seek independent professional advice on the tax consequences of acquiring, holding and disposing of EIS qualifying shares before proceeding with an investment into either a Single Company or Fund.

Highlights

- An individual can invest annually up to £1 million in EIS companies and obtain a tax credit equal to 30% of the cash investment
- For EIS it is possible to invest up to £1 million in 2013/14 and carry back £1 million to 2012/13, provided certain conditions are met.
- Certain types of trade do not qualify for EIS relief. These include certain financial activities, property development, hotels and providing legal or accountancy services.
- A 'disqualifying arrangements' test has been introduced to exclude VCTs, EIS or SEIS that do not invest in qualifying companies and are set up solely for the purpose of giving investors tax relief.

The following sections analyse the main features:

- Income tax credit on the amount invested and when it may be withdrawn;
- The capital gains tax exemption and/or utilisation of capital losses on the disposal of the shares;
- Deferral relief, provided the relevant conditions (explained below) are met; and
- Business Property Relief (BPR) from inheritance tax (IHT), where certain conditions are met.

Income tax

- Income tax credit at 30% of the amount invested in subscribing for new shares (maximum annual investment of £1 million).
- By election, where an EIS investment is made in one year it can be treated as though it was an investment made in the immediately preceding tax year, subject to the overall limit for that year.
- Dividends paid on EIS shares are taxable.
- Where the EIS shares are sold within 3 years, the EIS investor receives value or an option is placed over the shares, then the EIS tax credit is clawed back.

The claw-back amount is the lower of:

- Original income tax credit; and
- 30% x sale proceeds received (only applicable if sold for a loss) There can also be a claw-back if the company loses its EIS status within 3 years.

Capital Gains Tax (CGT) Relief

- An EIS investor is entitled to exemption from CGT on a disposal of those shares, provided he has held them for three years. Therefore, any growth in value is effectively tax-free.

Relief for Capital Losses on Disposals

- Relief is given for allowable losses arising on the disposal of the shares against either income of the tax year of disposal (or of the previous tax year) or chargeable gains, provided all the relevant conditions referred to below are met
- Any income tax relief obtained under EIS, which was not withdrawn, reduces the capital loss.

CGT Deferral relief

- The tax due on a gain on any asset can be deferred by subscribing for shares in EIS qualifying companies, in a period beginning one year before and three years after the disposal of the original asset.

Business Property Relief

- Shares in EIS companies held for at least two years will normally qualify for 100% BPR for IHT purposes.

EIS Conditions

For EIS purposes, both the investee company invested and the investor need to meet certain conditions:

Conditions to be met by the company:

- The company's gross assets must not exceed £15 million immediately before the shares are issued and £16 million immediately afterwards
- The Investee Company must be unquoted when the shares are issued and there must, broadly, be no arrangements for it to become quoted. A company admitted to AIM will not be regarded as quoted for these purposes
- The Company must exist to carry on a qualifying trade (i.e. conducted on a commercial basis with a view to making profits; and the trade does not include, to a substantial extent (20% or more), excluded activities such as property development, leasing, dealing in land, shares and/or commodities etc
- The company must not be a 51% subsidiary of another company
- The Company must not have any subsidiaries that are not 51% subsidiaries
- The-issuing company must either be a UK resident company carrying on a trade in the UK or be an overseas company with a UK permanent establishment carrying on a trade
- The Company must not be in financial difficulty
- The Investee Company must have fewer than 250 full-time employees
- The Investee Company cannot raise more than £5 million in total over a 12-month period under the EIS and the VCT scheme.

Conditions to be met by the investor:

The key conditions are as follows:

- The subscription must be in newly issued, ordinary shares and paid for in cash, as well as being for genuine commercial reasons and not for tax avoidance purposes
- To retain the income tax relief and to be exempt from capital gains tax, the shares must be held for at least three years
- The investor must not be connected for EIS purposes with the company.
- Investors who are connected with the company cannot claim income tax relief but may still qualify for capital gains tax deferral relief
- An investor will be connected with the company if he, either on his own or with associates, possesses or is entitled to acquire more than 30% of the issued share capital, voting power or assets of the company or any subsidiary on a winding up
- An investor will also be connected if he or she is an employee of the company or its group. They can be directors provided they meet certain conditions. An investor must not receive any amount of remuneration as a director that is excessive in comparison to the services performed. Relief will be withdrawn if the investee company, or a person connected with the company makes a payment to the investor (which is not “insignificant”) up to one year before, and three years after, the share issue.

Single Company - Advance Assurance

Advance Assurance is issued after the Company or Fund submit an application to HMRC which includes a business plan, market research, individual management team details and projected financials. After successful consideration, the applying company or fund receive authority to issue certificates under Section 204(1) ITS 2007 in respect of ordinary shares issued to individuals, following receipt of a properly completed form EIS1 within the time limit prescribed by Section 205(4) ITA 2007.

It should be noted:

- Responsibility for the accuracy of the information supplied and considered by HMRC rests wholly with the company.
- Provisional assurance is based solely on the information supplied in and with the clearance application and will not apply in circumstances that vary from those described therein. The Company or Fund must therefore forward particulars of any proposed changes, and the draft of any shareholders subscription, investment or similar agreement, for clearance prior to the issue of shares.
- The clearance does not guarantee the availability of any form of relief under the Enterprise Investment Scheme to any particular subscriber.

Single Company - No Advance Assurance

- Whilst Advanced Assurance does not guarantee the availability of any form of relief under the Enterprise Investment Scheme to any particular subscriber, it does provide an agreed framework for such availability subject to the application made, thus providing the investor with a certain level of confidence at the point of investment. No Advance Assurance means that not only is the investor taking a risk on the projects success, he or she is also risking any tax relief incentives with on the way in (Income Tax Relief), upon exit (Capital Gains Relief) or in the event of the project failing (Loss Relief).

Fund - Advance Assurance

- Fund Advanced Assurance is obtained in exactly the same way as described within the Single Company EIS example shown above. However, the single difference is that the Fund undertakes to invest all funds into qualifying single EIS companies within a specified 12-month period, thus allowing investors and IFAs the ability to structure investments within a deliberate tax planning process.

Fund - No Advance Assurance

- Whilst Advanced Assurance does not guarantee the availability of any form of relief under the Enterprise Investment Scheme to any particular subscriber, it does provide an agreed framework for such availability subject to the application made, thus providing the investor with a certain level of confidence at the point of investment. No Advance Assurance means that not only is the investor taking a risk on the Fund Manager's ability to invest the funds in a qualifying company, he or she is also risking any tax relief incentives involved with that investment within a specific period of time that may suit the investor with regard to either; Income Tax Relief (on the way in), Capital Gains Relief (upon exit), or in the event of the project failing Loss Relief (upon liquidation). The Fund Manager is under no obligation to invest capital within a specified period of time, making individual tax planning difficult.