

The Enterprise Investment Scheme

A Guide for Investors

The Enterprise Investment Scheme (EIS)

The Enterprise Investment Scheme (EIS) seeks to encourage individuals to make equity investments in the higher risk small to medium sized unquoted company sector, by offering a raft of tax reliefs

The Tax Reliefs

In order to encourage investment in EIS companies, the government offers tax reliefs. These can give total tax reliefs of up to 98% of the sum invested:-

EIS cash subscription	£100,000
Income Tax relief at 30%	£(30,000)
CGT Deferral relief at 28%	£(28,000)
Inheritance Tax relief at 40%	£(40,000)
Net cost of investment	<u>£ 2,000</u>

The Tax Reliefs in Detail

A) Income Tax Relief

An investor who subscribes in cash for ordinary or non-cumulative fixed preference shares in an EIS qualifying company can obtain income tax relief of up to 30 per cent on investments of up to £1,000,000 each year. This relief can be claimed either in the tax year the investment is made, or in the previous year.

B) Inheritance Tax Exemption

Provided a shareholder has owned shares in a qualifying unquoted trading company for at least two years and certain conditions are met at the time of transfer, inheritance tax business property relief of 100 per cent is available, which reduces the inheritance tax liability on the transfer to nil.

There is no limit on the amount you can invest in EIS Companies for Inheritance Tax relief purposes.

C) CGT Deferral Relief

Investors with capital gains made up to three years before or one year after an EIS investment is made can claim 'deferral relief' against those gains.

Deferred gains do become taxable again on certain events, such as a sale of the EIS shares.

The £1,000,000 annual limit does not apply for CGT deferral relief purposes - any amount can be deferred.

D) Exemption from Capital Gains Tax

If an investor holds EIS shares for at least three years, any capital gain realised on the disposal of the shares will be both income tax and capital gains tax free, provided income tax relief has been given and has not been withdrawn.

E) Loss Relief

If a loss is made on the disposal of EIS shares at any time, the loss may be claimed against either current year or future capital gains, or, by election, against income of the current or previous tax year. The effect of this, for a 45% taxpayer, is to reduce the loss as follows:

EIS cash subscription	£100,000
Income Tax relief at 30%	£(30,000)
Loss relief	<u>£(31,500)</u>
Net loss	<u>£ 38,500</u>

Note though that a loss made in the 2013/14 tax year can be carried back to 2012/13 for relief at a top rate of 50%.

Qualifying Unquoted Trading Company

There are a number of conditions that a company must fulfil in order to qualify under the Enterprise Investment Scheme. In brief, the main conditions are as follows.

The company or its subsidiary must carry on a qualifying trade which excludes certain financial and so-called 'passive' activities such as hiring plant, letting property and receiving royalties.

Additionally, certain land-backed trades such as operating hotels, nursing homes, farming, forestry and property development do not qualify, nor do shipbuilding, coal mining, steel production, or legal and accounting services.

A company does not qualify if its gross assets immediately before the EIS share issue exceed £15m or immediately afterwards exceed £16m. The company must have fewer than 250 employees when the shares are issued, and the maximum amount that can be raised from Venture Capital Schemes is £5m in a twelve month period.

If a company fails to meet the conditions in the three years following the investment, or an investor sells or otherwise disposes of the shares, the tax reliefs will be lost.

The Investment Process

Before investing in a company offering EIS reliefs, investors should consult their tax and financial advisers.

Additionally, investors should ask to see the Company's Advance Assurance letter from HM Revenue & Customs.

Advance Assurance does not guarantee that EIS tax reliefs will be available, but it does give a degree of comfort.

Provided the company has been trading for at least 4 months, they will then apply to HM Revenue & Customs for the EIS certification and investors should receive an 'EIS3 Certificate' within a couple of months.

However, the Company cannot apply for the certificates from HMRC until it has traded for 4 months.

The EIS 3 Certificate is needed before a claim for any of the EIS tax reliefs can be made. Investors' tax or financial advisers will be able to assist with the claim if necessary.

EIS Funds

Finding the right company to invest in can be problematic for investors. One approach to this problem is to invest in an EIS Fund. These operate in a similar way to Venture Capital Trusts or Unit Trusts - the fund manager selects and monitors the companies invested in.

However, with an EIS Fund the investor is the beneficial owner of the underlying investments, rather than owning units in a unit trust.

Investing through a Fund also enables the investor to spread their risk as a Fund will typically invest in at least four different companies.

Risk

Investors considering investing in EIS Companies must remember that the tax reliefs are only available because investing in this type of business is perceived as high risk.

Additionally, shares in unquoted companies can be difficult to sell, should you wish, or need, to liquidate your investment.

How can we help?

If you would like more information about the EIS or other issues surrounding equity investment in your business, please contact your usual BDO contact or David Brookes, Tax Partner, on 0118 925 4445 or email david.brookes@bdo.co.uk.

www.bdo.co.uk

How can we help? BDO's EIS and VCT specialists provide a full range of expertise, covering both tax reliefs for investors and guidance to companies seeking investment. For more information, please contact your usual BDO contact or one of the following:

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