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Accounting resource: **Enterprise investment scheme (EIS).**

In brief:

The Enterprise Investment Scheme aims to encourage investment in small companies with the intention they will grow and create employment. These investments are often risky and so attractive tax breaks are offered to investors.

"Business angels should always investigate the opportunities for making their investment using EIS. Whilst it won't make a bad investment into a good investment, it will make an investment more attractive."

"The 30% tax relief on investment is a very attractive incentive, particularly when combined with no CGT on any gains on EIS shares and the ability to defer gains on any other assets on investment"

Alan Ross, Tax Director, Wilson Partners Ltd wilson partners.

Enterprise investment scheme (EIS)

Tax reliefs:

There are four key tax reliefs available to investors:

1) A reduction in your income tax liability of up to 30% of the value of your investment (subject to an annual maximum investment of £1m [or £2m where knowledge intensive companies]). In order to get the reduction, you need to have a sufficient tax liability. Unlike many other reliefs, this one is not caught by the 25% of income / £50,000 cap. All or part of the investment can be treated as made in the previous tax year.

2) Any gain on disposing of the shares is exempt from tax. If the shares are sold at a loss, the loss net of any income tax relief received at the outset can be set against other income of the year of disposal or the previous year (again, not caught by the 25% of income / £50,000 cap).

3) The capital gain on the disposal of any other asset can be deferred where the gain is invested in an EIS qualifying company. There is no limit to the amount that can be deferred. The gain crystallises on the disposal of the EIS shares.

4) The value of the shares will be eligible for 100% Business Property Relief for Inheritance Tax and any deferred gains disappear on death.

Tax relief examples:

Example 1:
Investor invests £50,000 in EIS shares producing £15,000 of income tax relief. More than 3 years later, the shares are sold for £200,000. As the proceeds will be tax free, the overall post tax profit is £165,000.

Example 2:
Investor sells a property and makes a gain of £50,000 on which the CGT would be £14,000. The £50,000 is invested in EIS shares producing £15,000 of income tax relief and deferring £14,000 of CGT. More than 3 years later, the shares are sold for £10,000. On sale, there is a loss of £25,000 (£50,000 less £15,000 less £10,000) on which up to 45% income tax relief may be claimed - a further £11,250. The £14,000 of CGT deferred becomes payable. In this example, even though there is a £40,000 loss on the investment, the real loss is only £13,750.

Conditions:

As you might expect, such attractive reliefs come with complex set of conditions to be satisfied, including:

1) The company must have or be preparing to have a qualifying trade. Broadly, financial activities or those linked to a significant property (eg hotels, farming, property development, renewable energy and care homes) don’t qualify. It cannot be a subsidiary of another company nor have companies it controls but has less than 50% of the shares. It must have fewer than 250 employees (500 for a knowledge intensive company) and have assets of under £15m before the investment and £16m after it.

2) The investor must face a risk to capital as a result of investing (i.e. it must be possible for the investor to lose more money than they could gain from their investment taking account of tax relief and dividends).

3) The company cannot raise more than £5m (£10m for knowledge intensive companies) in any 12 month period under EIS, SEIS and VCT, and there is a lifetime limit of £12m (£20m for knowledge intensive companies).

4) The shares must be newly issued, fully paid, non-redeemable ordinary shares in an unquoted company.

5) Generally the company must raise funds within 7 years (10 years for knowledge intensive companies) of trade starting. Beyond this it will need to demonstrate that the funds are being used to enter a new market.

6) The investor cannot be connected with the company in the period from 2 years before investment to 3 years after investment. Connected includes being an employee or holding more than 30% of the shares (taking account of any shares owned by close relatives). The investor can however be a director. Also there are restrictions on investment by existing shareholders.

7) There must be no loans to the investor linked to the investment, and the subscription must be for genuine commercial reasons.

8) Relief can be withdrawn if the company ceases to qualify, the investor becomes connected, the shares are sold within the three years of issue, or the investor receives value from the company (dividends and reasonable director’s remuneration are OK).

Conclusion:

Whilst obtaining relief may be complex, EIS can make investing in small companies highly attractive. It can make a significant difference when comparing two investments, one of which may qualify and one which may not.

This note is a brief summary of the position at 04/07/22. Professional advice should be taken before any EIS investments are made.