Enterprise Investment Scheme

Hazlewoods

The Enterprise Investment Scheme (EIS) is designed to help smaller high-risk trading companies raise finance. It does this by offering a range of tax reliefs to investors who subscribe for shares in those companies.

EIS is an extremely complex subject area, and the following information should serve only as a summary.

When is EIS available?

The tax reliefs apply to 'qualifying investors' who subscribe in cash for 'relevant shares' in 'qualifying companies' undertaking a 'qualifying business activity' and providing the 'risk-to-capital' condition is met.

Am I a 'qualifying investor'?

A 'qualifying investor' is an individual who has subscribed for shares in cash in a qualifying company subject to the below conditions:

No connection with the issuing company (this condition does not apply for Capital Gains Tax (CGT) deferral relief). An individual will be deemed to be connected if they:

- are an employee, director (but see below) or partner of the company or any of its subsidiary companies or partners;
- are an associate (e.g. business partner, spouse, parent or child, but not sibling) of such an individual;
- own or are entitled to acquire more than 30% of the share capital, or voting rights, or are entitled to more than 30% of the assets in the event of a winding up of the company or a subsidiary (associates holdings are taken into account).

Certain individuals can be directors without being considered connected to the company for these purposes, these include 'unremunerated directors' and 'business angels':

- no linked loans – either to the investor or an associate (a 'linked loan' is a loan which would not have been made on the same terms if the investor had not subscribed for the shares).
- existing shareholdings – at the point of investment, the investor must not hold any other shares in the company unless they are SEIS, EIS or SITR qualifying, or subscriber shares.
- no tax avoidance – the investor's subscription must be for genuine commercial reasons and not be part of a scheme or arrangement the main purpose or one of the main purposes of which is to avoid tax.

For how long must the qualifying investor conditions be met?

The first two conditions must be met for the two years prior to the share issue and three years after the share issue or, if later, three years after the date the company starts to trade. The existing shareholdings requirement and no tax avoidance motive must be satisfied at the point the shares are issued.

Are my shares 'relevant shares'?

'Relevant shares' are new ordinary shares issued in a 'qualifying company' for bona fide commercial reasons.

The shares must be fully paid up at issue and must not be redeemable. The shares must not be cumulative preference shares nor preference shares where the date and amount of the dividend is determined by the company's articles.

Any changes to the share capital within the three years following issue (whether changes to the EIS shares or not) could result in the EIS investment ceasing to qualify.

Is the company I am investing in a 'qualifying company'?

The issuing company must:

- have a permanent establishment in the UK from the point of issue and for three years following;
- be a company or a parent company of a group carrying on a qualifying trade for the three years after the share issue;
- be in good financial health at the date of issue (not 'in difficulty');
- be unquoted (can be listed on the Alternative Investment Market for the purpose of this relief);
- employ the funds raised from the share issue for qualifying activities, either by it or a 90% subsidiary within two years of the share issue, or within two years of trading if it is a new trade;
- where it is a parent company, have a majority shareholding in, and control over, any subsidiary companies that it holds
- be independent i.e. not under the control of another company;
- If a land or property management subsidiary, the parent must hold at least 90% of the issued share capital and voting power (and be beneficially entitled to at least 90% of any profits or assets distributable to equity holders)
- have fewer than 250 full-time employees (or less than 500 employees for knowledge-intensive companies). Where it is a parent company, the group must have fewer than 250 full-time employees.;
- the gross assets of the company (or group where it is a parent company) must not exceed £15 million immediately before the investment and £16 million immediately after the investment;
- not itself, nor any of its subsidiaries, have raised more than £5 million from EIS, Seed Enterprise Investment Scheme (SEIS) or Venture Capital Trusts (VCT) in the last 12 months;
- This is subject to an overall cap of £12 million (£20 million for knowledge intensive companies);
- the qualifying trade must be less than 7 years old (10 years for knowledge intensive companies) when receiving their first EIS investment (unless there has been a previous issue of shares under EIS, SEIS or VCT or the money raised must total 50% of the company's investment and must be used to enter a new geographical market or new product); and
- not have been set up for the purpose of accessing the relief.

What is a 'qualifying business' activity'?

The company must have a qualifying trade and have a permanent establishment in the UK. This should remain the case for three years from the share issue date or, if later three years from the date the trade starts.

Qualifying trades include all forms of trade except certain excluded activities such as: dealing in land; financial activities; legal and accountancy services; operating or managing hotels or nursing homes; farming; property backed activities; shipbuilding; coal and steel production; trades including the benefit of Feed in Tariffs, generation of electricity, heat or other energy and producing gas or fuel.

'Risk-to-capital' condition

A principles-based test applies for investments made on, or after, 15 March 2018. There are two parts to the condition, both of which must be met:

1. the company invested in must have long-term objectives to grow and develop; and
2. the investment must carry a significant risk the investor will lose more capital than they gain as a return (including any tax reliefs).

Some guidance is available on factors to consider when looking at this condition, but it is non-exhaustive and will depend on the specific facts and circumstances of each investment.

Are there investment limits?

You can invest any amount in EIS shares. But to qualify for income tax relief and CGT exemption there is a maximum subscription of £1 million. This is extended to £2 million where investments are made in 'knowledge intensive companies.'

Knowledge intensive companies are broadly those engaged in the creation of intellectual property and/or which employ a high proportion of skilled employees.

What are the tax benefits for me?

30% income tax relief

The relief is 30% of the sum invested. It is to be set against the individual's income tax liability for the tax year in which the investment was made. Subject to the annual investment limit of £1 million, you can elect for shares issued in the current year to be treated instead as issued in the previous year. This may be useful if your current year liability is insufficient to use all the relief.

CGT exemption

Assuming you are a qualifying individual, and you hold eligible shares for more than three years from the issue date (or three years from the date trade starts if later) any capital gain on the disposal will be tax free.

Loss relief

If you dispose of the shares at a loss, you can elect that the amount of the loss, less any income tax relief given, can be set against income of the year of the disposal, and/or any income of the previous year, instead of being set against capital gains. This is outside the £50,000 IT loss relief cap introduced from 6 April 2013.

CGT deferral relief

CGT on a gain from any asset disposal can be deferred against an EIS share subscription. The tax on any gain deferred in this way becomes payable on disposal of the EIS shares or if you stop being a UK resident within three years of the share issue or if the shares lose their EIS status.

- Any amount of gain can be deferred;
- You can be connected to the company;
- Income tax relief does not need to be claimed to qualify for CGT deferral relief;
- When the deferred gain becomes chargeable on the disposal of the EIS shares the gain will be taxed at the rate of CGT in force at that time (rather than at the rate applicable at the time of the original disposal).

If you would like to discuss further, please get in touch.

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